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CHINA UNDER THE FOUR MODERNIZATIONS

Part 2

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LETTERS OF TRANSMITTAL

DECEMBER 27, 1982.

To the Members of the Joint Economic Committee:

I am transmitting for the use of the Joint Economic Committee, Congress, and the interested public a compilation of papers assessing the economy of China entitled "China Under the Four Modernizations, Part 2." This compilation contains current information and analyses of China's foreign economic relations.

We are grateful to the Congressional Research Service of the Library of Congress for making available the services of John P. Hardt, who helped plan the scope of the research and coordinated and edited the contributions. Dr. Hardt was assisted by Kate T. Tomlinson, formerly of the Congressional Research Service staff. The project was supervised for the Joint Economic Committee by Richard F. Kaufman.

The views contained in this study are not necessarily those of the Joint Economic Committee or of individual Members.

Sincerely,

HENRY S. REUSS,
Chairman, Joint Economic Committee.

DECEMBER 22, 1982.

Hon. Henry S. Reuss,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a volume of studies on the Chinese economy entitled "China Under the Four Modernizations, Part 2." The studies were written by specialists who were invited to contribute because of their expertise about China. The authors come from universities, research organizations, and agencies of the Federal Government.

Views expressed in the papers are those of the individual authors and do not necessarily represent the views of their organizations or of members of the Joint Economic Committee.

Sincerely,

RICHARD F. KAUFMAN,
Assistant Director, Joint Economic Committee.

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SUMMARY

By John P. Hardt

I. MODERNIZATION: A ROCKY COURSE

The determination to modernize the economy of the People's Republic of China on the course initiated by Mao's successors in 1977 continues.

The drive toward normalization of China's economic relations with Japan, the United States and the other advanced industrial economies is resulting in increasing degrees of interdependence.

However, the Four Modernizations, the program for modernizing agriculture, industry, science and technology, and defense has undergone considerable changes since it was first announced in 1977. Having realized that it was much too ambitious, given China's current capabilities, the leadership is in the process of adjusting, reorienting and retrenching the Four Modernizations into something more pragmatic, realistic and attainable. The main lines of the modernization program still obtain, but the adjustment may occupy much of the decade of the 1980s:

> Economic development is still the overriding imperative, but the reliance on costly major projects is being reduced. For example, the mammoth, modern Baoshan iron and steel complex is being scaled down to a more attainable size and schedule.
>
> Although implementation of economic reforms such as decentralization of planning and the introduction of incentives continues, efforts have been made to retain necessary central control and economic stability.
>
> Western systems and processes are still important, but the measuring rod for China's modernization is no longer the acquisition of the most advanced Western technology, but a judicious blend of foreign experience and self reliance.
>
> Improvement in living conditions is still an important goal, but the earlier expectation that China could rapidly move beyond meeting the subsistence requirements of its citizens must be tempered.

Uncertainty about the effectiveness and permanence of the adjustment persist. Retrenchment may yet become reversal. Leadership changes may resurface at least some of the old ideological priorities evident during the Cultural Revolution and the Great Leap Forward. Likewise, the priority of the fourth modernization—that of the military—may rise and threaten the preeminence of the other three.

The normalization of economic and political relations with Japan, the United States and other advanced Western economies continues to contribute to modernization. But, normalization has also been reassessed and adjusted:

Western imports for major projects have been cut back in accordance with China's limited hard currency reserves and special technological requirements.

Institutions, legal systems, market practices are still in a state of flux. While Western practices are emulated, they are also being adapted to China's special circumstances and needs.

Barriers to Western economic relations such as expropriation claims, political constraints and tariffs and credit restrictions continue to be reduced, but the full use of Western business and governmental banking facilities is pursued at a more measured, selective pace.

Just as political stability is critical to modernization and normalization, adjustment of Chinese modernization and normalization is critical to political stability and economic growth in the P.R.C. Opportunities for Western exporters in the China market, business facilitation, financial mechanisms, and legal facilities all turn on the pace and character of normalization. Once again Western exporters have seen through the "oil for the lamps of China" mirage and adopted more modest expectations for new and profitable China markets. Chinese planners, in turn, have scaled down their plans to fit technical and financial possibilities.

Military modernization may, in turn, benefit from the widened prospects for American military sales. Still, limited Chinese hard currency reserves as well as continued American caution may preclude any substantial flow of arms from the United States to China.

II. Future Modernization Uncertainties

Prospective improvements in the economy of the People's Republic of China may bring problems as well:

1. The post-Mao leadership has given high priority to economic modernization, professionalism, and incentive systems in planning and management. The PRC's need for Western products and processes has created an opening for greater influence and a favorable environment for closer commercial ties with Japan, the United States, and other Western industrial economies.
2. The rapprochement between the United States and the People's Republic of China has been followed by increasing political, commercial, scientific, social, and other relations. Commercial relations have expanded due to China's stated needs for Western technology. Limited oil revenues and a more restrictive attitude toward credit suggest constraints on wider commercial ties in the future. Since our continuing ties with and arms sales to Taiwan are serious barriers to rapid improvement in political and military relations, improved economic ties may be the most attractive avenue for improving Sino-American relations for the immediate future.
3. The leaders of the PRC have given priority to economic modernization. Although the purchase of foreign military technology is part of China's current long-term policy, Western influence is still likely to be greatest in relation to China's economic needs. In spite of the possibilities for progress in controlling population growth, the Malthusian specter still looms in China's fu-

ture. Transfers of agricultural technology from the West may be critical for the long run. Although only marginally significant in the short run, imports of grain may at times provide a critical margin.

4. Effective planning and management turn on accurate and timely information. The poor quality of statistical processing in the past, especially during the Cultural Revolution, poses problems for Chinese planners and makes it difficult for Western analysts to evaluate the Chinese economy's prospects. In recent years, modest, but significant, improvements in the quantity and accuracy of published economic data, empirical evidence from exchanges, and substantially increased Western access to the end users of Western imports have aided Western analysts in appraising China's economic policy and performance.

It is difficult to separate long-term or cyclical trends from variable or temporary factors in performance. Nonetheless, it seems clear after three decades of power that Chinese leaders aim to develop a modern, powerful, industrial state that would be capable of dealing on equal terms with the superpowers, while providing adequately for its citizens' needs. The current Chinese development plans, however, are not characterized by the Stalinist urgency to overtake and surpass the West in a short, definite time period—a goal the Chinese themselves expressed during the period of the Great Leap Forward.

Against this long-term aim of achieving an economic basis for superpower status, from time to time China has pursued political, ideological, and social policies that derailed the progress of economic nation-building in the short-term. These policies threatening the primacy of economics may re-emerge in the years immediately ahead and influence economic performance:

Political succession.—Inevitably, the 79-year-old Deng—the architect of and the power behind China's current policies—will be challenged or die. Efforts at installing successors to Deng will lead in all likelihood to an unsettling struggle rather than an orderly transfer of power.

Revival of ideological preeminence.—There have been times such as the Great Leap Forward and the Cultural Revolution when the emphasis on ideological revitalization conflicted with policies to improve economic performance. If this experience is repeated, stable long-term growth may be jeopardized. To assume that no recurrence of these economically disturbing political-ideological cycles is likely is, on the one hand, to assume that cycles in the past were primarily due to the unique force of Mao's personality and, on the other hand, to de-emphasize the broader base of support for the "Yenan" revolutionary spirit in the Party and nation as a whole.

Foreign threats or opportunities requiring more weapons and military forces.—Concern about the Soviet Union may at any time lead to a major shift in Chinese military policy or a force buildup. In addition, Peking might well become more actively involved in supporting Asian Communist powers if circumstances were different, despite present indications of military restraint.

III. UNCERTAINTY OF THE FUTURE

Modernization of the Chinese economy launched with such high hope and expectations in 1977 has run into rough sailing. Adjustment, reorientation, and retrenchment have been necessary almost from the outset. Yet important progress has been made and significant changes have been initiated.

The achievement of a modern, industrial, competitive economy by the People's Republic of China is not certain for any particular future year, certainly not for the year 2000. However, China has the resource potential, the skills and the will to change. A formidable task lies ahead, but success should not be ruled out.

Joining the economic powers of the region and the world may be some time off for the People's Republic of China. China has launched modernization. The Western nations have adopted a policy of "normalization", accepting China into the global family of economies. Active and equal participation by China as an industrial nation in the world market is some years off.

IV. CONTRIBUTORS' INSIGHTS ON CHINESE MODERNIZATION AND NORMALIZATION

The authors of the chapters in this volume are American specialists on China. Many have drawn on recent experience in the People's Republic of China. The cooperation of Chinese officials and citizens and the authors' access to key people and institutions in the major cities and in the countryside have greatly enhanced the quality of insights. The interest of Chinese officials and scholars in previous volumes on the Chinese economy released by the Joint Economic Committee contributes to U.S.–P.R.C. cooperation and mutual understanding. This interest is evidenced by the publication of complete official Chinese translations of previous volumes in large editions, which have been widely distributed in the People's Republic of China.

Some of the major questions addressed in the studies in both volumes, and indications of some of the authors' responses are illustrated below:

1. *Is the current leadership committed to putting the economy of the People's Republic of China on a path of stable, continuous economic growth? Does this new course amount to an irreversible change from past development policy?*

> Deng Xiaoping has led the right-wing survivors of the two-line struggle in their steady rise to power within the post-Mao leadership over the years since the death of Mao and the overthrow of the Gang of Four in 1976. This new or post-Mao leadership is dedicated to reestablishing China's economy on the path of sustained growth during the 1980s as a necessary precondition to the long-run achievement of the Four Modernizations. In their search for the path of sustained growth the post-Mao leadership has introduced a whole series of new economic policies and reforms made necessary by the economic problems, policies, and institutions they inherited from the past. . . . [T]he post-Mao economic program is the result of a continuous process of experimentation in their search for the path of sustained growth; a process which has encountered problems and undergone several twists and turns, but which is likely to continue throughout the 1980s.
>
> Taken as a whole the post-Mao leadership's program of economic policies and reforms has become an across-the-board attempt to change the traditional Chinese development model. . . . [T]hey also have led to many favorable changes in China's economy that augur well for the attempt to regain self-sustained growth. [Dernberger, "The Chinese Search . . .," Vol. 1, pp. 19, 20.]

2. How will the political dynamics of the post-Mao era influence future economic policy? Will political dynamics change the character of the Chinese development model formulated under Mao's rule?

Some Chinese leaders have been particularly outspoken in arguing that sweeping political reforms are a prerequisite for an effective pursuit of the four modernizations.

The reforms include changes in Chinese laws, institutions and administrative practices, but at their heart are major leadership changes. Following the death of Mao and the arrest of the "gang of four" in late 1976, Chinese leaders inherited a massive administrative structure staffed by cadre seriously divided along ideological, generational, institutional and factional lines. Reformers like Chinese Communist Party (CCP) Vice Chairman Deng Xiaoping recognized that Chinese decision making on economic development and other programs would continue to be disrupted by such divisions unless they managed to establish a more unified and competent leading group at the top levels of the party, government and army. . . .

Prospects for solving these kinds of leadership differences appear uncertain. . . .

A cautiously optimistic scenario for the next few years holds that Chinese reformers will continue to make slow and halting progress toward the establishment of a more unified, pragmatic and technically competent leadership that will gradually develop a more coherent modernization program capable of eliciting more active support from Chinese officials and people. [Sutter, Vol. 1, pp. 77, 78.]

3. What have been the major developments in the Chinese economy since Mao's death?

1. After an initial burst of overoptimistic economic plans, the post-Mao government has brought its modernization goals in line with China's real needs and available resources.

2. The government has provided more inputs for the agricultural sector, raised farm procurement prices, and encouraged private plots and peasant markets.

3. Concurrently, Beijing has canceled or postponed major construction projects, particularly heavy industry projects with expensive foreign equipment.

4. The People's Liberation Army, while continuing to improve in weaponry and discipline, has had to accept a stretchout in its re-equipment program.

5. Scientists have returned to laboratory and classroom, universities have restored their admission standards, and gifted students have gone abroad to master Western technology.

6. The government has re-affirmed the clear-cut goal of the population control program—one child per family.

7. The consumption sector has gained new impetus from measures favoring agriculture, light industry, and small-scale handicraft and service enterprises.

8. The People's Republic has broadened its participation in the international economic system, joining the IMF and World Bank and seeking credits from a wider variety of sources.

9. These pragmatic programs will help offset factors pushing down growth rates in the 1980's, such as diminishing returns in agriculture, the overloading of transportation and communication facilities, the dearth of modern accounting and statistical methods, the apparent spread of cynicism and self-indulgence, and the drawbacks of a Soviet-type system for running an increasingly complex economy.

10. In particular, the recent peaking of oil production at 2 million barrels per day (plans had called for 5 million b/d by 1985) will dampen growth by reducing China's ability to buy foreign machinery and technology.

11. Because of the absence of a charismatic leader like Mao Zedong and the economy's development of deeper roots, political turbulence probably will disturb economic activity much less in the 1980's than in the first three decades of communist rule.

12. The huge population will remain the single most dangerous long-term threat to maintaining rapid growth; today's one billion Chinese will have increased by at least 200 million at century's end, even assuming the success of the government's population control program.

13. In short, while growth rates in China almost certainly will fall off in the remainder of the century, the new pragmatic policies will greatly reduce chances of a precipitous decline.

14. The People's Republic will realize substantial absolute gains in agriculture, industry, defense, and science and technology, while remaining far behind the standards of Japan and the leading Western nations. [Ashbrook, Vol. 1, pp. 100–101.]

4. *Has China's transportation network been expanded in the last decade to meet the burgeoning needs of the economy?*

China's transportation networks continued their remarkable growth during the 1971–1980 period. All the modern transport sectors—rail, road, water, air, and pipeline—set new records in freight handling; the traditional sector continued supplementing the modern sector by moving large quantities of goods over short distances. . . .

In spite of the impressive increase in freight turnover since 1970, China's transport systems at present are barely sufficient to meet economic development needs. In 1980, the railroads, carrying 50 percent of national freight turnover in the modern sector, remained the predominant form of transportation. However, the utilization of railroads is near saturation nationwide and in some areas is lagging behind transport needs. Water transport was second, handling 44 percent of the turnover volume. Here, the need for continuous dredging of waterways and harbors and for the modernization of ports and the inland fleet restricts expansion of inland water routes and development of harbors. With a limited number of only poor quality highway routes, the highway departments played mainly a supportive role to other sectors as road traffic accounted for only slightly more than 2 percent of turnover. In light of the recent slowdown in oil production, the pipeline sector, handling 4 percent of modern turnover, probably is the only sector not being pushed to capacity. For the air sector to significantly increase its contribution to the transportation infrastructure, cargo-handling facilities and internal transport system linkages will require modernization. [Peterson, Vol. 1, p. 139.]

5. *What are the likely ranges of population growth and how has China been controlling population growth? What are the problems and prospects of the new, upcoming census?*

A major change has taken place since 1978 in the availability of national and provincial population data from China and in the policies of the Chinese government toward statistics in general. . . .

Some of these data show a demographic impact from the food crisis of 1959–61 that is far more serious than most foreign observers had supposed. Chinese sources say that there was even a net loss of population in one or two of the years.

Other doubts are raised by the extremely rapid declines in fertility and natural increase in the country as a whole and in some of the provinces between 1970 and 1980. Recent Chinese sources have been quite candid in discussing widespread falsification of statistical data in China, and several say that births are deliberately underreported in order to show success in family planning work. . . .

Concern about the reliability of population data is one of the reasons why the Chinese leaders have decided to take a new census. But the census poses a threat of exposure to those local leaders who have falsified population data. The critical question is whether the census field procedures can be designed in such a way as to make sure that the census returns are immune from local manipulation before they are submitted for tabulation. . . . The census has attracted worldwide attention because it is the largest census ever undertaken and is expected to provide answers to many of the long unanswered questions about China's population. [Aird, Vol. 1, pp. 172–173.]

6. *The urban and rural labor forces of China are sharply different in terms of their economic and social roles. How does primarily rural collective labor differ from predominantly state-run urban labor?*

Since completion of the land reform and collectivization of agriculture and traditional trades and socialization of the modern sectors of industry, construction, transport, trade, and finance in the 1950's, employed Chinese have worked in either one or the other of two basic types of enterprise or organization, one a collective undertaking and the other a state-run organization. Upwards of 90 percent of the population of China works in (and are members of) collectives, which are predominantly (although not exclusively) rural, while the remainder work in state-run undertakings, most of which are located in urban areas. Collectives are responsible for their own profits and losses and, in general, are not eligible for investment made under the state plan or for any other form of state cash distributions, except for disaster aid. State-run undertakings, on the other hand, receive state subsidies, as needed, and investment made under state economic plans. . . .. The state sector, representing less than 20 percent of the population, primarily urban and nonagricultural, receives almost all of the investment made under the state economic plans and almost all of the subsidized welfare and educational services and entertainment that the state provides, and is fed on what amount to state-subsidized rations of grain, edible oil, meat, and fish purchased from the rural peasant population usually at fixed prices set by the state. On the other hand, the more than 80 percent of the population, mostly peasants, that provides most of the labor used to produce the food consumed in China, receives very little in return, small amounts of cloth and other rationed items but very low social and welfare services. This situation can be viewed in several ways. One way is to think of it is as most of the peasant population supporting the favored few in the cities. Another is to consider the two sectors as two separate economies which have very few interconnections. Either way, it is perfectly clear that it costs the state much more to support one city dweller eligible for state grain and other rations than to maintain one peasant at a subsistence level of living.

Differences between urban and rural standards of living have preoccupied Party leaders ever since the completion of collectivization and socialization programs in 1957–1977. [Emerson, Vol. 1, pp. 235, 236.]

7. *Why has Chinese modernization not entailed urbanization, as has been the pattern elsewhere? Have the Chinese avoided the problems of urbanization common elsewhere?*

While modernization normally implies urbanization, China has been attempting to modernize without increasing the proportion of the population that lives in cities and towns. This may be a unique experiment in the history of nations and has required innovative approaches to many economic and social problems. Some have worked, some have failed, and some are still being tested. But while China is struggling with unemployment, pollution, housing shortages, land use, consumer services and innumerable other difficulties that stem from urban growth, Beijing does not know how many people live in the urban areas.

The experience of the People's Republic of China has been quite different from that of other developing nations. China's urban growth has had its ups and downs—periods of "blind infiltration" by the peasants and of forced evacuations—but over the past three decades China has been able to limit the flow of population into the cities and thereby has avoided some of the worst consequences of urban sprawl. She has not found any magic solutions, however, and "success" is only relative. Her urban problems may appear somewhat more manageable simply by virtue of controlled urban migration, but they are actually numerous and serious. In a sense, by "bottling up" the rural population, Beijing has spread a host of problems more evenly between town and village. And, in a sense, this was Mao's intention. [Orleans, Vol. 1, pp. 268, 270.]

8. *How are key industries adjusting to meet the needs of modernizing China? What kind of constraints and stimuli do energy supplies exert on Chinese economic growth?*

In the last four years, both Chinese and Western perceptions of the outlook for Chinese industry have changed drastically. At the National People's Congress in March 1978, Premier Hua Guofeng announced an ambitious ten-year plan for the modernization of the Chinese economy. Steel was expected to grow from 25 million tons in 1977 to 60 million tons in 1985, and the gross value of industrial output was planned to increase ten percent annually.

The Chinese felt the planned 10-percent rate was attainable because they attributed the poor industrial performance during the previous several years (especially 1974 and 1976) to political disruption. . . . Many Western economists recognized at the time that the targets of the ten-year plan could not be fulfilled by 1985, but neither they nor the Chinese planners had enough data to understand fully the nature and scope of the problems.

Even as these important limitations to growth were surfacing, a fundamental crack appeared in the foundation of China's modernization plan. Planners in Beijing—who were counting on continued high growth in oil output to fuel and finance the modernization program—found that oil prospects had been seriously overstated. In contrast to 10-percent annual growth they had anticipated, they were faced with the prospect of a decline in output. This rapidly emerging problem has led us to examine the impact of energy shortages on industrial output over the next five years.

We have concluded that energy constraints alone will slow the industrial growth rate to between 3 and 5 percent annually through 1985, compared with 9.6 percent in 1975–1980. Heavy industry will probably continue its downward drift through the mid-1980s, and even under the best of circumstances, will barely make up for the decline we anticipate in 1981. The tight energy supply, particularly of oil products, will probably force Beijing to intervene repeatedly in the allocation of fuel, implying strong central control.

This general pattern will persist until the energy shortage is relieved. [Field/Flynn, Vol. 1, pp. 335, 357.]

Construction of the Baoshan Steel Mill began in 1978 as a symbol of China's drive to develop one of the world's advanced industrial economies by the year 2000. The projected six million ton per year Shanghai-area plant was to be the linchpin in the expansion of the industry viewed as the key link in overall development. It was also designed to be a showcase example of gaining access to state of the art technology through cooperation with foreign companies.

By 1982, however, Baoshan has become synonymous with difficulties and setbacks encountered in the modernization drive, and with abandonment of goals and changes in priorities. . . . [M]ost of the controversy over the plant is connected with larger policy issues, such as what China's industrial priorities should be, and what role foreign companies should be allowed to play in China's economy. Above all, Baoshan's turbulent history shows how greatly economic planning and political struggle have affected each other.

In the final analysis, Baoshan has been an expensive failure. But at the same time, it signifies many potentially positive changes. The plant has driven home the need for thorough feasibility studies for major projects. It has contributed to the Chinese understanding that there is more to modernization than buying advanced technology. Finally, Baoshan's history suggests that China, to an extent without precedent in Stalinist command economies, may succeed in overriding the influence of the bureaucratic heavy industrial interests that have done so much to distort development patterns in Socialist countries. [Weil, Vol. 1, pp. 367, 391.]

In the last three years, the government of the People's Republic of China has released far more data on industrial performance than have been available since the 1950s. . . .

As more and more data have become available, the observer of the Chinese economic scene can answer hitherto unanswerable questions. Are the GVIO [gross value of industrial output] and physical output data consistent? Are the current figures comparable to those published in the 1950s? And do they accurately reflect the growth and change in industrial structure of the last three decades? . . .

The official and estimated branch of industry indexes for 1979 . . . [compiled by the author—Ed.] are remarkably close, despite the theoretical deficiencies of the official indexes and the practical shortcomings of the indexes that I estimated. For those industries producing relatively homogeneous goods—such as metallurgy, electrical power, coal, building materials and timber—and for the slower growing, more stable light industries—such as food products, textiles and paper—the data suggest that the official and estimated indexes are consistent. For the more rapidly growing petroleum, chemicals and machinery industries, however, the conclusion is not so clear. . . . Nevertheless, it appears that GVIO indexes are reasonably reliable measures of Chinese industrial output. [Field, Vol. 1, pp. 304, 312, 314.]

9. *What progress has been made in Chinese plans to reform industry?*

In the two years after December 1978, the People's Republic of China initiated a broad set of economic reforms. In December 1980, industrial reforms came to at least a temporary halt. . . .

By the end of 1980, more than 1600 of these so-called "specialized industrial corporations" or general plants had been formed in China, each controlling an average of ten plants. The corporation's function is to redistribute production processes among these plants in a more economically rational way.

This activity will undoubtedly succeed in garnering some universally obvious efficiencies. But the policy is not a part of true economic reform; indeed, in some ways it is reform's antithesis, a device for streamlining and facilitating continued central planning. . . .

Where does this leave us? The most that one can say is that fundamental reform is still on the agenda. [Reynolds, Vol. 1, pp. 119, 136, 137.]

10. *Rural industrialization is often described as a uniquely Chinese aspect of industrialization. How has it fared in recent years?*

[T]he rural industrialization program of People's Republic of China deserves close study. With over one million small-scale enterprises employing well over 20 million workers, the Chinese program is unparalleled not only in size, but also in innovativeness. Of special interest are the 600,000 enterprises in the "five small industries" of iron and steel, farm machinery, chemical fertilizers, cement and hydroelectricity. Using modified versions of technologies that were long ago obviated in the West, these small-scale, relatively labor-intensive plants constitute an important experiment in the use of intermediate technologies. At their peak, they produced major portions of output in these industries; in 1978, they accounted for almost all of the small and medium farm tools and machinery, over half of the chemical fertilizers (by weight), 65 percent of the cement, etc., that were supplied to the agricultural sector. . . .

While it is often impossible to isolate problems and attribute them exclusively to a single cause, we can nevertheless discern two distinct categories of problems afflicting the rural industrialization program. One category is discussed under the heading of "techno-economic" problems, which includes problems involving the viability of technologies used in the small-scale plants, choice of plant scale, and plant location vis-a-vis skill and resource supplies. The second is broadly termed "administrative," and it includes problems of policy, performance indicators, investment choice criteria, tautness of State plans, and coordination among decision-making units. [Wong, Vol. 1, pp. 395, 397.]

11. *How has agricultural modernization fared in the readjustment period? Will Chinese agriculture be able to meet rising consumer needs? How successful have programs for improved agricultural productivity been?*

Agriculture, long a weak link in China's economy, has a new and critical role to play in meeting China's evolving commitment to higher standards of living. This commitment is an important underpinning for the claims to legitimacy of the new leadership. It is also crucial to efforts to raise productivity and generate greater economic growth through more reliance on material incentives. The higher real incomes required by this commitment mean substantial new demands on agriculture on top of a backlog of unfulfilled demand accumulated in past years of economic stagnation. Failure to meet these demands will seriously compromise China's current drive for modernization and sustained economic growth.

China's agriculture at the beginning of the eighties appears positioned to grow somewhat faster than historical growth rates, at least through the mid-eighties. But no major breakthroughs in production are imminent. . . .

China's leadership is stressing productivity gains from new policies as the major stimulus to agricultural growth in the eighties. More decentralized decisionmaking, greater reliance on material incentives, and growing specialization and commercialization of agriculture are being counted on to increase the quantity of output that can be produced with available supplies of land, labor, capital, and current inputs such as fertilizer. These policies will have to be successful if growth rates are to rise. . . .

The increases that can be reasonably expected may be insufficient to meet the full range of demands on agriculture. A serious shortfall would generate pressure for further changes in agricultural policy and possibly for a reassertion of centralized control over agriculture. [Surls/Tuan, Vol. 1, pp. 419, 420.]

Chinese grain production can now be maintained at a level that supports an adequate basic diet. The problem the Chinese face now that they can feed themselves is improvement in the quality of the diet. China's present government gives high priority to raising personal incomes and living standards. Quality foods, especially meat, will be viewed by the Chinese as an important aspect of raising living standards. If per capita incomes rise, as they will if the Chinese are successful, increases in consumer demand for non-grain food products will press

China's agricultural production capabilities for the rest of this century. Recent increases in meat, oil and sugar supplies have begun to partially meet this demand but population growth and technical and resource limitations will make continued increases in per-capita supplies difficult. [Kilpatrick, Vol. 1, pp. 449–450.]

The main thrust of China's past strategy for agricultural development has been maximization of annual crop yields through further intensification of cultivation techniques. It is an emphasis which is broadly consistent with China's resource endowments—lack of unexploited arable land and surplus of labor. It also seems generally consistent with the peasants' goal of farm income maximization, because of an institutional framework in which labor is rewarded in workpoints rather than fixed wages and, at least in the past, a production technology which involved minimal dependence on the industrial sector. That is, the goals of the state and the peasant should be reasonably consistent. . . .

But this consistency or harmony of objectives has unequivocably broken down in Suzhou Prefecture (an eight-county area in Jiangsu Province just west of Shanghai Municipality). The area is representative of the frontiers of high-yield, labor-intensive cultivation technology in the PRC. It is favored by natural conditions, abundant labor, developed mechanization, and a reliable irrigation and drainage system. . . .

The projections express a conviction that in Suzhou the Chinese strategy of yield maximization through intensification of cropping and labor use has at once reached its highest state of development and the end of the road. Further development of Suzhou agriculture means a retreat from this approach, and movement toward the kinds of modern agricultural practice found today in Japan, South Korea, and Taiwan. [Wiens, Vol. 1, pp. 462, 474.]

12. *How have the efforts to modernize science and technology fared in the post Mao period? What is the outlook for Chinese science and technology? What is the Chinese attitude towards technology transfer and how effectively do the Chinese assimilate Western technology? What is the Chinese approach to the Communist dilemma of choosing between "red" and "expert" and traditional Chinese problems of elitism? What is the status of professional economists in today's China?*

An enormous scientific and technological wave crested in 1977 and 1978, when, because science and technology were to spearhead the Four Modernizations, China announced some extremely ambitious goals that incorporated expensive projects and plans in a variety of fields. The wave hit on some contradictions in 1979 and 1980. Specifically, the authorities had disregarded shortages in scientific and technical manpower and serious financial constraints. They now admit that they were too impetuous, were deceived by "expectations for easy success," and had an "inadequate understanding of China's reality." Thus, the wave began to recede. But another wave of a different size and configuration is already cresting. Now Beijing maintains the basic problem in the past was a lack of coordination between scientific and technical work and economic work. Under the present policies of readjustment and reform, more attention will be devoted to the "problems of application and development in science and technology." There will be less basic research and much effort will be expended toward "absorbing foreign production techniques suitable to our own national conditions." To accomplish this task Beijing is insisting on much closer contacts between scientific research institutes and production enterprises.

The quick rise and recent downturn of the status of the Chinese scientist prompt some important questions. . . .

Can today's China accommodate a conspicuous return to the historical dichotomy between the man of learning and the rest of the society? . . .

A degree of scientific exclusiveness is a universal phenomenon—and up to a point it is supported and perpetuated by all of us. But why should the dichotomy between the man of science and the rest of society be greater in China than in the United States, for example? [Orleans, Vol. 1, pp. 475, 477, 478.]

The post-Mao drive for scientific and technological development, and the identification of science and technology (S&T) as key factors in the modernization of agriculture, industry and national defense, is thus but the latest reaffirmation of an elite recognition that reliable knowledge of the material world is essential for the transformation of China into a prosperous and powerful country. [Suttmeier, Vol. 1, p. 489.]

Noteworthy among the shifts in policy under the Four Modernizations drive are the positive sanctions now given to transfers of technology between the People's Republic of China (PRC) and the highly developed nations of the West . . . , underscoring the official line on the importation of technology: "We must also make use of foreign capital and technology and energetically develop foreign trade. However, we must emphasize self-reliance." [Wilson, Vol. 1, pp. 553, 568.]

China's ability to assimilate foreign technology is severely constrained by four factors: (1) uneven performance with respect to translating research results into the serial production process; (2) poor management capabilities, particularly in such areas as project integration and industrial organization; (3) technical backwardness, particularly in precision instrumentation and testing equipment; and (4) insufficient numbers of qualified S&T personnel to assist with the management and adaptation of imported technology. These problems are critical constraints in both the civilian and military sectors. Although the Chinese have made appreciable progress during the past several years at remedying many of their deficiencies, most of the above are deep-seated problems with long-term solutions. The Chinese must first upgrade their basic capabilities in such fundamental areas as alloy processing, computer and electronics development and applications, and systems management before imports of foreign technology will have an appreciable impact on their modernization program. [Simon, Vol. 1, p. 514.]

Economists and economics enjoy a dominant position among the social sciences in China's academic and research institutions. . . . Judged from the standards, methods, and objectives of contemporary Western economics, my impressions concerning the current state of academic training and research in the field of economics in the PRC lead one to a very pessimistic conclusion. This gap between the state of the arts in the field of economics between the two countries may be somewhat alleviated in the future. This can be achieved by the sending of Chinese students to study in the United States and other Western countries and by the sending of Western economists to China to give and hold seminars or joint conferences. It can also be furthered by the revival of imports of Western journals and books in the field of economics. However, the small scale of these activities and the limited extent to which they are grafted into the main stream of academic training and research in economics in China will, I believe, do little to close the existing gap in the near future. [Dernberger, "The Status of Economics . . .," Vol. 1, pp. 569, 577.]

13. *Has military modernization remained in its position as last in priority? Why is this and what does the future hold in terms of military priority in resource allocation?*

China's military modernization strategy thus seems to be one of delay, of suboptimization, of capitalizing on known assets and of balancing enemy against enemy. Thusly defined, China will probably continue to adhere to the requirements approach for the next several years (barring, that is, major political reorientation internally or large-scale conflict with the Soviet Union or its Vietnamese ally) . . . . If a prediction may be ventured, therefore, it is for relative stability of direction and pace of Chinese military modernization along lines by now clearly evident. [Robinson, Vol. 1, p. 596.]

China's defense modernization program, a two-decade effort aimed at improving the People's Liberation Army (PLA) and the defense industries, is making limited progress but has far to go. The effort arises from deep-rooted apprehension over Soviet military capabilities and from the leadership's desire to "move China into the front rank of nations" by the year 2000. It will be successful only if the nation enjoys prolonged political stability, retains access to foreign capital and technology, avoids costly foreign military campaigns, and moves forward in higher priority efforts to modernize agriculture, industry, and science and technology.

China's prospects for military modernization are influenced by strengths and weaknesses in its political, economic, and technical bases. The country suffers from a serious shortage of trained technicians and deficiencies in key technologies and defense industries. The principal factors favoring success of the modernization drive include the leadership's dedication to the program and the availability of foreign technical and financial assistance (to the extent that Beijing can pay for costly technology). [Jammes/Lamborn, Vol. 1, p. 597.]

China announced in February of 1981 the start of a program of "further economic adjustment" that calls for a reduction in the current national budget, including defense funding. The program also entails a restructuring of the economy toward light industry and a reemphasis on centralized investment decisions. In light of China's worsening economic situation, and the new economic program's shift in priorities away from defense-related industries, the cut in the defense budget may portend a period of lower defense spending lasting several years. [Mitchell, Vol. 1, p. 605.]

14. *How has the PRC's international economic policy changed under the post-Mao leadership? How have the major construction projects been related to foreign trade plans? How will hard currency income restrict imports? Japan, a natural Western trading partner, has expanded China trade. With what success? What is the future of the U.S. grain trade with China? What steps has China taken to join the international economic institutions: GATT, IMF, World Bank, etc.?*

In the five years since the death of Mao Zedong China's new leaders have moved the country unrelentingly toward greater participation in the world's economy. Beijing has dropped its ideological aversion to foreign debt, encouraged foreign investment in the domestic economy, established trade and diplomatic relations with the United States, joined the International Monetary Fund and World Bank, decentralized its foreign trade organizations to promote direct foreign contacts at the enterprise level, and sent thousands of students abroad in search of a Western education.

More importantly, fundamental Chinese attitudes are changing with respect to the role of trade in a planned economy. Imports are viewed decreasingly as an instrument to serve the needs of the state and increasingly as a means of satisfying the needs of the people. Exports no longer are seen purely as a means of paying for imports, but also as a leading force for upgrading China's domestic industry. By encouraging China's sleepy domestic industries to compete to earn foreign exchange in Western markets, the leadership is attempting to improve the quality of goods produced for the domestic market as well. The Chinese now recognize that in order to maximize the gains from trade they must specialize along lines of comparative advantage—it is no longer enough to export whatever happens to be in surplus domestically. . . .

Despite the rapid increase in trade, China's exports still amount to only a small fraction of domestic output, and a tiny part of world trade. The leadership is genuinely displeased that a nation with nearly one-fifth of the world's population and one-twentieth of the world's economic output, still accounts for less than one percent of the world's trade. They are determined to move China forward into the mainstream. [Davie/Carver, Vol. 2.]

During 1978 a series of contracts valued at $7.8 billion for the supply of equipment and technology for 22 major projects were signed with foreign companies. These activities created great interest among the Western business community in what was conceived as a vast potential of the China market. This period is now characterized in Chinese press articles as *yangyejin*, meaning a leap outward toward foreign countries for the supply of capital and technology, in contrast to the Great Leap Forward relying largely on indigenous, labor-intensive methods some 20 years earlier.

The period of *yangyejin*, however, was relatively short. After a sober assessment of the country's economic situation, Chinese planners came to the realization that there were serious problems in the capital construction sector caused by poor planning, inefficient management, and excessive investment, and that these problems were exacerbated by a further upsurge of investment activity during 1978. As a result, steps were taken in early 1979 to scale down the capital construction program, and many of the 120 major projects were cancelled or postponed. Negotiations with foreign firms slowed down considerably. . . .

Despite China's greater "openness" toward foreign trade and investment, the current retrenchment coupled with various constraints on repayment and absorptive capabilities will limit the immediate and short-term (1–5 year) prospects for any large-scale participation in Chinese capital construction projects by foreign companies. In the next few years, however, significant business opportunities could exist for a number of selective projects. . . .

The long-term (5–10 years) prospect for foreign participation in China's capital construction will hinge on the success that the PRC will have in acquiring foreign capital and technology through various arrangements for the projects in the above four categories in the next few years. That success will greatly facilitate the current readjustment process, and a successful readjustment will almost certainly mean a greatly increased role for foreign capital, equipment, and technology in China's development planning. That success also will increase China's repayment and absorptive capabilities, as well as its confidence and experience in implementing a more open approach. [Chen, Vol. 2.]

High priority probably also will be given to projects that require less hard currency, provide a quicker return on investment, and offer potentially greater export earnings. . . . China's hard currency exports to the West—the PRC's major source of foreign exchange—are expected to slow in 1981–85, largely because of Beijing's efforts to improve living standards, shortfalls in oil production, and growing Western protectionism. Exports of manufactures, especially textiles and other light industry goods, should continue to be the driving force behind China's hard currency export growth.

Under high and low scenarios, projected Chinese hard currency import capacity in 1985 ranges from $44.2 billion to $58.1 billion. Projected 1985 exports, meanwhile, total $41.6 billion to $54.2 billion. As a result, the implied average growth rates for China's hard currency capacity over the next five years are 20 percent and 27 percent while the rates for exports are 19 percent and 25 percent. [Gullo, Vol. 2.]

Japan now stands as China's leading trade partner with about 20 percent of its total exports and imports. The two economies share a natural complementarity buttressed by differences in level of development, wage levels, capital stock, and natural resource endowment. This complementarity provides for large gains to be made from specialization and exchange. Japan's high level of technological development, mechanization, and wage levels combined with a near absence of natural resources contrast sharply with China's lower levels of manufacturing technology, wages, nascent mechanization, as well as abundant reserves of natural resources. . . . [G]eographical proximity, long historical ties, close ethnic identification, the opportunity for mutually advantageous trade, the Chinese-perceived threat from the Soviet Union, and the sheer size of each economy compel closer economic ties between the two countries during the 1980s. These ties have been flourishing under the new institutional framework for Sino-Japanese economic relations developed during the 1970s.

In the China market, Japanese exports often compete directly with those from the United States. Except in iron and steel products, in which Japan holds a major cost advantage and in agricultural goods, in which the United States holds dominant advantage, U.S. and Japanese firms frequently compete head-on for sales to China. . . .

In 1980, for example, while the United States exported $3,754.4 million in merchandise to China, Japan exported $5,108.7 million dollars' worth. [Nanto, Vol. 2.]

China has been a significant importer of grain since the early sixties. In the late seventies, however, China's grain purchases and its importance in world grain markets rose sharply. This surge of imports has had an important impact on U.S. exports of grain, particularly wheat. During 1980 China was the leading export market for U.S. wheat, taking 17 percent of all U.S. exports. Since PRC purchases are concentrated in cheaper grades of wheat, China's impact in this sub-market has been particularly dramatic. During the 1980/81 wheat marketing year which ended in May 1981, sales to China of 6.2 million tons accounted for 73 percent of total U.S. exports of soft red winter wheat. The U.S.–P.R.C. grain trade agreement, signed in October 1980, sets an annual range of 6–9 million tons for U.S. grain sales to China during the 4 year period which began in January 1981. China will therefore continue to be an important market for U.S. grain in years to come. [Surls, Vol. 2.]

Given the size and potential of the Chinese economy, the organization and management of that economy, the nature of a Contracting Party's obligations within GATT, and the complexities of certain methods of PRC entry into GATT, there are likely to be advantages as well as disadvantages for both China and the GATT should the PRC join. . . .

Whether the advantages of the PRC's entry into GATT will outweigh the disadvantages will largely be determined by the mutual desire of the PRC and the GATT Contracting Parties to negotiate a method and terms of accession which will, on the one hand, be acceptable and feasible for China and will ensure, on the other hand, PRC adherence to GATT principles and obligations and effective Chinese reciprocity to GATT members. [Liser, Vol. 2.]

15. *Normalization of commercial relations between the United States and the PRC has been an uneven process. What is the balance sheet? What American legislative and policy barriers restrict further normalization? Extension of trade benefits (MFN tariff status) has had some effects on U.S. imports and employment. How serious have they been? How do Chinese trade practices limit the development of normal trade? Has the development of legal institutions contributed to Chinese modernization and normalization? Have issues such as treatment of industrial and intellectual property and unsettled U.S. claims inhibited trade? How do U.S. firms view their experience in the China trade?*

For over two decades following the Communist takeover of China, commercial relations between the United States and "Mainland China" were virtually nonexistent. During most of that period, the stand-still was principally the result of a comprehensive embargo that the United States imposed on trade with Mainland China after the direct involvement of the Communist Chinese in the Korean War. . . .

The embargo on commercial relations with the PRC was lifted in mid-1971, and by legislative action the PRC's access to some U.S. Commodity Credit Corporation programs was authorized in 1978, a bilateral trade agreement between the United States and the PRC, providing among other things for the reciprocal granting of most-favored-nation status, was approved in 1979, and the PRC's eligibility for the operations of the Overseas Private Investment Corporation was authorized in 1980. Also in 1979, the PRC gained access to Eximbank export credit facilities. . . .

With all this, the U.S. commercial policy toward the PRC and trade relations with it still are not normal in the sense that one would characterize as "normal" the policy toward and relations with the countries of the non-Communist world. Apart from a certain degree of unavoidable functional abnormality that is inherent in trade with a country whose economy is under comprehensive State guidance and control, there still exists a number of U.S. statutory and administrative measures which place on commercial relations with the PRC restrictions that do not apply to the U.S. trade with most of its other trading partners. [Pregelj, Vol. 2.]

Using trade turnover as an indicator, the success of the U.S.-PRC normalization process is quite impressive. Trade turnover stood at $1.1 billion in 1978, it doubled to $2.3 billion in 1979 and doubled again to $4.8 billion in 1980. U.S. exports to the PRC have far outpaced imports, with the Chinese trade deficit growing from $424 million in 1978 to $1.1 billion in 1979 and $2.7 billion in 1980. These large Chinese trade deficits tend to obscure the impressive growth of U.S. imports from the PRC, which expanded from $324 million in 1978, to $592 million in 1979, and to slightly over $1 billion in 1980. . . .

The results suggest that in 1979, U.S. imports from the PRC would have exceeded actual imports by approximately $134 million, or 25 percent had PRC imports been dutied at MFN rates throughout the year. The industries most affected include ceramic products, footwear and textiles and apparel. This translates to a loss of approximately 8600 employment opportunities in the United States. The increased imports in the textile and apparel industry alone would account for approximately 4600 fewer employment opportunities. Had the PRC also enjoyed country-beneficiary status under the U.S. GSP program during 1979, U.S. imports from the PRC would have exceeded actual and MFN imports by 22.2 million, or 4.2 percent. For the ceramic products industry, additional imports of approximately 48 percent of actual 1979 trade would have been generated by GSP. For the furniture and wood products industry the increase would have been 25 percent.

The employment estimates resulting from MFN and GSP status presented in this paper are job opportunities, and are not necessarily changes in actual employment. Normal industry growth, labor force turnover and increased exports to the PRC may offset job opportunity losses in many industries. [Bayard, Orr, Pelzman, Perez-Lopez, Vol. 2.]

China's efforts to organize foreign trade parallel its problems in planning and implementing modernization. The Chinese leadership is still getting organized, a process that will take at least two years and may cover the entire 6th Five Year Plan. In the foreign trade sphere, organization efforts have focused on decentralization, which has long term implications and problems. Foreign trade must succeed if modernization is to work because considerable foreign investment and technology will be drawn from outside China. Current foreign trade policy has the dual purpose of reducing China's foreign exchange shortages and maximizing China's access to world technology. [Monk/Rich, Vol. 2.]

In 1977, when China's leaders dedicated themselves to the four modernizations, they consciously decided to reestablish formal legal institutions as part of their ambitious plan of growth. In light of China's legal history since the Communist victory in 1949, this decision is significant. Since 1949 law had borne the heavy imprint of politics; since the late nineteen-fifties, the Chinese leadership had shown little concern for the fate of formal legal institutions; during the Cultural Revolution, the legal system had virtually disappeared. . . . The most prominent [of the functions served by the new institutions] appear to be (1) reinforcement of discipline and maintenance of social order, (2) control of official arbitrariness, and (3) prospective guidance of organizational and individual behavior, particularly economic. No institution serves only one function, and Chinese legal institutions already serve mutually inconsistent ones. Moreover, in the future some of their functions may change in ways unforeseen or unintended by their creators.

Lastly, some observations have been included on the role of law in China's international economic relations. New laws and regulations have been adopted recently and more are to come. The leadership appears to have the goal of establishing a framework for foreign economic activity in China, including direct investment and a variety of transactions hitherto uncommon or unknown in the China trade. But progress towards creation of a system of clear and consistently-enforced rules to guide foreigners and Chinese officials alike is likely to be very slow. [Lubman, Vol. 2.]

At the present time, Chinese leaders are contemplating significant changes in their treatment of industrial property. New patent and copyright legislation and amendments to China's trademark legislation are in the works. Moreover, interesting reforms foreshadowing these new legal systems have been introduced and are already affecting China's technology transfer activities. [Kirk/Denny, Vol. 2.]

On that cold March morning in 1979, the public waiting room of the Beijing Airport may have seemed an unlikely place for Chinese and American officials to signal agreement on unfreezing the so-called "frozen assets," but the timing came as no surprise. Two months earlier, the United States had finally recognized the People's Republic of China (PRC) as the sole legal government of China. The day before, the U.S. representative, then Treasury Secretary W. Michael Blumenthal, had presided over the official metamorphosis of the U.S. Liaison Office into the first U.S. Embassy in Beijing in 29 years.

In the two years since the settlement was concluded, Sino-American economic relations have indeed progressed. The resolution of the claims/assets problem was by all accounts a prerequisite for that progress, and while the implementation process continues—the last PRC payment is not due until October 1, 1984—the settlement itself is primarily of historical significance. [Lichtenstein, Vol. 2.]

The China market, a place for US companies to buy and sell goods and services, has historically held a promise of fortune. As relative late comers to the market place of "New China," US firms still sense the old promise, but for many initial high hopes have moderated. During the early 1970s, after the 21 year trade embargo was lifted, newly gained access to a quarter of humanity enticed US company executives en masse to draw up plans for capturing just a small percentage of the China market, which appeared vast from the viewpoint of a single company.

At present, there is not a very big pie for so many eager US firms to share. While some American companies have fared well in China, a few very well, most have not. Substantial gains for the majority of US companies in China will be made in the longer term. [Groen, Vol. 2.]

The experience of one U.S. company—Control Data Corporation (CDC) of Minneapolis, Minnesota—will be used to highlight commonality of interest and other key elements of U.S.-Chinese commercial negotiations. Specifically discussed are the CDC negotiations between 1973 and 1978 for the sale of equipment for seismic data processing centers to China.

The CDC contractual negotiations are important because they represent the sale of significant high-technology items to China and also because by themselves they represent, in dollar terms, a significant share of the total trade turnover for the years in which the transactions occurred.

As of June 1981, however, the U.S. Government still had not granted final approval for the entire transaction. [De Pauw, Vol. 2.]

With political normalization achieved, President Carter and his cabinet recognized the importance of removing existing obstacles and establishing a framework for normal economic interchange. . . . To ensure that bilateral economic problems were quickly addressed, and that within the United States Government economic policy toward China was carefully coordinated, and reflective of U.S. strategic interests, the Carter Administration considered the merits of establishing a joint economic committee with the Chinese. It was envisioned that this committee would differ from joint commissions the United States had with other non-market economy countries, which then focused primarily on trade promotion and business facilitation. While commercial issues were recognized as a critical ingredient in an economic relationship with China, one of the major objectives of U.S. policy makers in the early days of normalization was to set up a forum which would oversee the re-establishment of all aspects of economic ties, such as finance, investment, trade, business facilitation, transportation, agriculture, science and technology, etc. During their January 30, 1979 meeting in Washington, President Carter and Vice Premier Deng Xiaoping discussed the possibility of creating a bilateral forum and agreed to establish a joint economic committee. [Haas, Vol. 2.]

V. Implications of Chinese Problems and Prospects for the Reagan Administration and the 97th Congress

Both China's problems, such as uneven economic development, the necessity to retrench, hard currency constraints, and the imbalance in its trade with the United States, and its prospects for economic growth, trade expansion, and attainment of great power status raise a number of policy questions.

CHINA AS A PREFERRED MARKET

In the near term China's limited supply of hard currency will constrain its imports. If the United States decides to facilitate Chinese purchases of industrial and agricultural products with additional government credits from the Export-Import Bank and the Commodity Credit Corporation, a more favorable policy than that applied to many other U.S. trade partners would be required. The immediate prospects for the China market may not warrant a preferential credit policy, but China's longer term economic and political prospects may merit consideration of such a policy.

BEYOND NORMALIZATION

Since the normalization of U.S. trade with China and the liberalization of controls on exports to that country, there has been considerable support for further reductions in trade controls. If this policy is chosen, the United States might consider treating China as a country not subject to the legal constraints of the "Communist country" and "state trading economy" status. Similarly, Chinese industry might be considered "state influenced" instead of "state controlled," in which case the more restrictive market disruption provisions that the U.S. applies to imports from communist countries would not be applicable to Chinese imports. To remove some restrictions, such as the market disruption provisions of Section 406 of the Trade Act of 1974, the mandatory inclusion of safeguard clauses in bilateral agreements, and the ban on imports of Chinese furs, legislation would be required. Other restrictions required by law, notably the ban on Export-Import Bank loans or loan guarantees for communist countries and the Jackson-Vanik Amendment to the Trade Act of 1974, which sets freedom of emigration as a prerequisite for most-favored nation tariff status, are waived for China and several other communist countries. A third category of restrictions, primarily export controls, may be liberalized at the President's discretion.

In moving beyond normalization, the United States should consider whether China's current policies are likely to endure. Because of the chance that the policies of the current Deng leadership could be reversed, any legislative or administrative initiatives should allow the United States flexibility to respond to major changes in policy. It may also be appropriate to consider the potential harm to import-sensitive U.S. industries such as textiles.

LONG-TERM PROSPECTS FOR TRADE AND ECONOMIC COOPERATION

Do the longer term prospects for the China market warrant a preferential policy in the present? If so, the United States might benefit from concluding a long-term economic agreement with China. Depending on whether foreign competitors followed suit, such an agreement could establish an institutional framework that could assure the United States an equal or privileged position in the China market for years to come. In the medium- and long-term joint U.S.-Chinese development projects in metallurgy, transportation, energy or agriculture might be a component of such an agreement. A formal U.S. study of the feasibility of such projects and their likely profitability for the United States might provide some insights on these questions.

ARMS SALES TO TAIWAN AND THE PEOPLE'S REPUBLIC

U.S. arms sales to Taiwan are a stumbling block in the development of closer economic and political relations with the PRC. Chinese displeasure will force the Congress and the Executive to consider the advantages and disadvantages to the United States of continued arms sales to Taiwan. It may also be appropriate to give careful consideration to the desirability of selling arms and dual-use technologies to the People's Republic, even though large Chinese purchases are unlikely in the near term. Military developments, once undertaken, are hard to reverse. Moreover, the United States would have little or no control over Chinese use of military force.

CHINA AS A GLOBAL AND REGIONAL POWER

The mixed pattern of Sino-American relations, in which the two countries' interests converge in some cases, but diverge in others, raises some questions about U.S. policy toward China's economic modernization and normalization of its economic and political relations with the non-communist world.

CHINA AS A POWER

If the United States continues to favor a unified, stable, and strong People's Republic of China what Chinese modernization policies are in our interest? Should we for example, encourage rapid industrial, agricultural and scientific and technological development through our political influence, scientific exchanges, and other means?

CHINA AS AN ACTOR IN THE ASIAN AND GLOBAL ECONOMIES

If Pacific rim economic interrelations develop further toward a Pacific community, should we encourage the PRC to be an active member? In moving toward "normal" economic relations should we refashion our laws and policy away from the restrictions imposed on trade with Communist countries?

WESTERN RECEPTIVITY TOWARD CHINA

If we determine that it is in our interest to play the "China card" as a means of countering the Soviet Union and, at the same time, to foster the modernization of China's economy and the opening of Chinese society to the moderating influences of membership in the community of nations, can we be sure that these goals are compatible? Is there a basis for a U.S. policy toward the PRC that nations with such diverse interests as Japan, South Korea, the ASEAN nations and India may adopt? What formal or informal economic steps might be useful to forge a common policy?

IV. FOREIGN ECONOMIC

CHINA'S INTERNATIONAL TRADE AND FINANCE

By John L. Davie and Dean W. Carver

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I. INTRODUCTION

In the 5 years since the death of Mao Zedong China's new leaders have moved their country unrelentingly toward greater participation in the world's economy. Beijing has dropped its ideological aversion to foreign debt, encouraged foreign investment in the domestic economy, established trade and diplomatic relations with the United States, joined the International Monetary Fund and World Bank, decentralized its foreign trade organizations to promote direct foreign contacts at the enterprise level, and sent thousands of students abroad in search of a Western education.

More importantly, fundamental Chinese attitudes are changing with respect to the role of trade in a planned economy. Imports are viewed decreasingly as an instrument to serve the needs of the state and increasingly as a means of satisfying the needs of the people. Exports no longer are seen purely as a means of paying for imports, but also as a leading force for upgrading China's domestic industry. By encouraging China's sleepy domestic industries to compete to earn foreign exchange in Western markets, the leadership is attempting to improve the quality of goods produced for the domestic market as well. The Chinese now recognize that in order to maximize the gains from trade they must specialize along lines of comparative advantage—it is no longer enough to export whatever happens to be in surplus domestically.

The transition from years of isolation to stronger involvement in international trade has not been easy. The Chinese leadership has had to deal with an entrenched bureaucracy that often substitutes political expediency for economic rationality. China today is short on technological and entrepreneurial talent, following years of neglect of a modern educational system. The statistical collection network is in disarray, interfering with any long-range planning. China's internal transportation and communications facilities are antiquated, hampering the exchange of goods between one village and another, not to mention between those villages and Yokohama, New York, or Rotterdam.

For many years to come, these intangible factors will be the chief constraints on China's foreign trade expansion, not the commonly perceived problems of slow domestic growth or weak foreign demand. Since 1977, China has maintained a real growth rate for exports of 20–25 percent per year by diverting marginal amounts of output away from domestic consumption and by breaking into established Western markets for these exports through competitive pricing policies. Despite the rapid increase in trade, China's exports still amount to only a small fraction of domestic output, and a tiny part of world trade. The leadership is genuinely displeased that a nation with nearly one-quarter of the world's population and one-twentieth of the world's economic output, only accounts for less than one percent of the world's trade. They are determined to move China forward into the mainstream.

II. FOREIGN ECONOMIC RELATIONS IN PERSPECTIVE

China's foreign trade and financial affairs from 1949 to 1976—the year of Mao's death—must be viewed within the context of Beijing's general political and economic objectives: Internally, to modernize a backward, war-torn economy and to preserve and strengthen the "democratic dictatorship" of the Communist Party; internationally, to safeguard the country's independence and to gain "big power" status by building up its political, economic, and military strength.

During the first decade of Communist rule, Beijing's great concern with achieving economic independence was shaped largely by China's unhappy experience in its earlier contacts with foreign powers. Reflecting this feeling, Zhen Dibao, a Chinese trade official, wrote:

> Beginning in the middle of the 19th century, the imperialist powers continuously invaded China, depriving her by force of arms of tariff autonomy and customs control . . . The American and British imperialists controlled China's Customs Service and utilized this agency to facilitate, by means of low duty rates, the dumping on the Chinese market huge quantities of their surplus stocks and the plundering of China's raw materials at cheap prices. Their crude economic buccaneering strangled our national commerce and industry, thus rendering China a semi-colonial state for a long period of time.

Following the rupture of Sino-Soviet relations in 1960, Beijing put even more stress on the goal of achieving economic "self-reliance": Nan Hanzhen, Chairman of the China Committee for the Promotion of International Trade in 1964, defined self-reliance in this way:

> It means that a country should manufacture by itself all the products it needs whenever and wherever possible . . . . It also means that a country should carry on its general economic construction on the basis of its own human, material, and financial resources.

In practice, China's policies of maintaining "economic independence" and "self-reliance" meant that: (a) the PRC had comparatively little interchange with or integration into the world economy; since the early 1950's China's exports never amounted to more than one percent of the world's total; exports normally amounted only to about two percent of China's GNP. (b) Imports were used basically to overcome bottlenecks in the domestic economy and were concentrated in industrial supplies and other goods that were critical to the needs of the state; imports of capital goods were aimed at import substitution rather than at expansion of export industries. (c) Exports were spread over a wide range of commodities and markets, so that adverse foreign economic situations would have minimal impact on foreign trade plans; since Beijing earmarked for export a small portion of almost everything produced in China, the commodity composition of China's exports reflected the make-up of the domestic economy. (d) China attempted to balance exports and imports, making only sparing use of credits. (e) China did not accept foreign investment in any form.

Since the founding of the People's Republic, China's trade has advanced in fits and starts. In general, trade has followed the changing fortunes of the domestic economy, rising during periods of political stability while suffering from the setbacks of the Great Leap Forward, the Cultural Revolution, and the struggle for power between 1974 and 1976.

A. The 1950's—A Tilt to the East

Political and economic necessity led to a heavy dependence on the USSR in the wake of the Communist Chinese victory in 1949. The need to rebuild a war-ravaged economy amid the Western trade embargo imposed during the Korean conflict impelled Mao Zedong to pursue a policy of "leaning to one side." Trade with the Soviet block shot up from only $350 million in 1950 to almost $3 billion in 1959, and accounted for two-thirds of China's total trade. The Soviet Union provided the wherewithal for China's industrialization efforts, supplying both capital goods and industrial materials such as petroleum, lumber and metals, By mid-1960 the Soviets had completed about 130 turn-key plants worth almost $1.4 billion—at the time one of the largest technology transfers in history.

China also fashioned its foreign trade and financial organizations after those of the Soviet Union. The Ministry of Foreign Trade was established in 1952, together with several foreign trade corporations which conducted trade in specific commodities: metals, machinery, chemicals, textiles, foodstuffs, etc. Not until 1955, however, did the state completely monopolize foreign trade. In contrast, China nationalized the Bank of China in April 1949, even before the Communist Party had gained complete control over the country. In order to halt capital flight and hyperinflation, foreign exchange controls were imposed at that time, and private traders were required to surrender all foreign currency holdings to the bank. Customs collection, of course, also fell immediately into the hands of the state, but not until 1951 was a new two-tiered tariff schedule promulgated.[1]

Despite close cooperation during the 1950s, tensions were building in the Sino-Soviet relationship. The Chinese have since claimed that the Soviets were pursuing their own form of economic imperialism by taking advantage of China's isolated position to extract the highest possible prices for their aid. The rift opened in mid-1960 when Moscow withdrew the 1,200 Soviet technicians then stationed in China, blueprints and all. This was an added blow to a Chinese economy already overstrained by poor agricultural performance and the excesses of the Great Leap Forward.

B. The 1960's—Reorientation to the West

Throughout the 1960's China's trade with the Soviet Union declined. Annual trade agreements were suspended in 1967 and relations hit bottom with the Sino-Soviet border clashes in 1969. Trade with the USSR, which had accounted for almost 55 percent of China's trade in 1959, was less than 2 percent of the total 10 years later.

The initial impetus to trade expansion with the non-Communist countries came from China's need for large-scale grain imports to offset harvest failures of the 1960's. Wheat imports from Canada and Australia began in 1961 and have been a major import item ever since. In addition, China began purchasing large amounts of fertilizer from the West to support its agricultural sector. With the economy stabilizing, China turned to Japan and Western Europe in 1963 for some $200 million worth of plant and technology. By 1966, China had shifted three-quarters of its trade to the West. During the height of the Cultural Revolution (1966-69), however, China's attentions turned inward and trade stagnated.

C. The Early 1970's—Trade Resurgence, then Retrenchment

The resumption of regular planning during the Fourth Five-Year Plan (1971-75) brought a new wave of trade. Beijing embarked on a $2.6 billion program to import capital equipment and technology to spur economic development. From 1971 to 1975, the dollar value of China's trade tripled; and the non-Communist share rose to nearly 85 percent—by far the largest share of any Communist country's trade. During the 1970's, nearly three-quarters of China's purchases came from the developed West. On the other hand, more than half of the hard currency earnings needed to pay for those imports were derived from China's sales to the LDC's.

While growth in the dollar value of China's trade was inflated by the effects of dollar devaluation and by rising prices in the West, real growth was still substantial—about 70 percent in the period 1971-75. Flexible exchange rates and unstable world prices, together with the global recession of 1974-75, created a new element of uncertainty for China's central planners. No longer could the Chinese plan for balanced trade simply by adjusting the targeted quantities of exports or imports within a framework of known world prices. As a result, China's trade strategy came unraveled in 1974. Rampant inflation in the West and heavy deliveries of machinery and agricultural products pushed import costs to a peak while the slowdown in the Western economies prevented China from obtaining expected export revenues. The crunch came in the second half of 1974 as rising repayments on grain credits from the previous year put strains on the balance of payments. Beijing reacted by curbing imports of industrial materials, canceling and postponing deliveries of agricultural products, and trimming back new plant purchases in order to reduce downpayment expenses. In real terms, imports continued downward through most of 1975, while exports recovered somewhat—largely as a result of increased oil shipments.

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[1] Although the raison d'etre for tariffs would seem to have disappeared when the state monopolized trade, this vestige of the pre-Communist period is still on the books. In instances where the commodity imported is not produced in China and thus does not have a predetermined domestic price, China adds the tariff charge to the cost of an import to determine the domestic price; however, it is not clear what, if any, impact the tariff has either on the decision to purchase, or on the choice of supplier. In past negotiations, the Chinese, like the Soviets, have offered a reduction in the level of tariffs in return for MFN treatment of their own exports.

Curtailing imports was by no means the only option open to Beijing. Had it not been for leftist criticism of the progressive trade and financial policies then being instituted by Zhou Enlai and Deng Xiaoping, China might have obtained more loans from the West to weather the storm. Exports, too, might have increased more rapidly in the absence of the "Gang of Four's" admonishments that Deng was a traitor who wanted to "sell China out to the imperialists," and turn China into a "raw material base." The political turmoil in the period between the purge of Deng and the death of Mao nearly caused a collapse of trade. China's imports plummeted by 40 percent in the second half of 1976, as negotiations came to a standstill because of inflexibility on the part of Chinese negotiators.

III. INTERNATIONAL TRADE IN THE POST-MAO PERIOD

With stability returning after the political upheaval of 1976, a favorable climate was set for an expansion of foreign trade. Trade did not recover quickly from the shocks of the previous year, however, due to planning and delivery lags. Imports remained depressed in the first half of 1977, and improved in the second half only as a result of heavy Chinese purchases in the world commodity markets. Exports remained depressed in real terms, suffering from domestic supply disruptions and from the much higher prices the Chinese asked for goods sold in late 1976. In fact, 1977 was the only year during the whole decade of the seventies in which the real value of exports declined. Nevertheless, it was the year in which Mao's successors made plans to turn around China's trade policies and put China on a new development course.

A. Initial Modernization Program—1978

With the accession to leadership of Hua Guofeng in September 1976 and of Deng Xioaping in August 1977, China embarked on a program to bring its economy up to "frontline status" by the year 2000. In February 1978 Hua launched the Ten Year Plan for National Development (1976–85), which set output targets for 1985 calling for agricultural production to increase 4 percent per year and industrial production to increase 10 percent per year. Hua announced that under the plan 120 major industrial projects were to be completed as the initial stage in the modernization drive. The list of projects included 10 steel mills, 9 nonferrous metal complexes, 8 coal mines, 10 oil and gasfields, 30 power stations, 6 railways, 5 harbors, petrochemical plants, and variety of manufacturing facilities for producing machinery and electric components. The most important difference between this plan and any of its predecessors was its sheer magnitude. Like before, the selection of projects continued to reflect a policy of emphasizing heavy industry at the expense of light, and a policy of import substitution—the plants were designed to increase domestic production of goods being imported, and thus ultimately to reduce imports and make China more self-reliant.

The Chinese press never released any data on the contemplated costs of these investment projects—perhaps an indication that no such calculation had been done. Japanese economists, who had consulted with the Chinese during the planning stage, estimated that China would have had to raise upwards of 500 billion yuan (approximately US$300 billion) in new investment capital to cover the domestic and foreign costs of the program. Of this amount, US$70–80 billion would have been needed to pay for plant and technology purchased abroad.[2] Although Hua later revealed that the Ten Year Plan was not in fact a "plan" but merely a loose outline of targets and a list of projects to be undertaken, China's Ministry of Foreign Trade began acting on these projects. By the end of 1978, TECHIMPORT, the foreign trade corporation responsible for plant and technology purchases, had negotiated for or expressed interest in about $40 billion worth of complete industrial plants.[3]

If little planning had been done to determine the costs of such an ambitious program, perhaps even less consideration had been given to the problem of raising the funds to pay for it. At the time the plan was launched, the Chinese believed that oil production would reach 250 million metric tons per year in 1985 and that a surplus of 30–50 million metric tons per year would be available for export—enough to bankroll a sizable plant import program. China's chief concern appeared to be finding a market for the oil, a major reason for China's interest in signing a "Long Term Trade Agreement" (LTTA) with the Japanese. Japanese firms were at first reluctant to accept the quantity of Chinese crude that Beijing wanted to sell, but in February 1978, after a year of hard bargaining, the LTTA was signed.[4]

The agreement guaranteed China a market for up to 15 million metric tons of crude oil and 9 million metric tons of coal per year by 1985. At the time the Chinese had hoped to sell more, and found the agreed figures disappointingly low. The oil and coal exports were expected to cover the cost of importing about $10 billion worth of plant, construction materials, and technology from Japan. This was not a barter agreement; each transaction was to be carried out under separate contracts. Since it was expected that during the first half of the agreement, the level of Chinese imports would exceed exports, the Japanese promised to accept deferred payments for Chinese plant purchases. The agreement postponed for future discussion the question of interest rates and terms on the credits.[5]

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[2] JETRO, "China Newsletter," No. 26, June 1980, pp. 18–19.

[3] Central Intelligence Agency, National Foreign Assessment Center, "China: Post Mao Search for Civilian Industrial Technology," ER 79-10020U, February 1979.

[4] Although private Japanese firms ran the negotiations, final agreement was reached only after Tokyo intervened. Legally, however, the agreement has the status of a private contract.

Recognizing that oil exports alone would not pay the bills, Beijing began taking steps to liberalize the structure of its foreign trade organization, permitting greater contact between Chinese producers and foreign buyers. Articles in the Chinese press called for increased attention to improving the quality of light manufactures, by producing to buyer's specifications on styles, labeling, packaging, and delivery dates.

Beijing also accepted cooperative production agreements and processing arrangements as a legitimate form of business contact with the West. And finally, during the summer of 1978, Beijing decided to set up special zones in Guangdong Province where foreign firms might participate in joint ventures with the Chinese, permitting foreign ownership of capital for the first time since the founding of the People's Republic.

Beijing also made a number of policy shifts to spur the acquisition of technology and to create an environment for absorbing Western know-how. More than any other single move, China's decision to allow thousands of its best students to attend foreign academic institutions reflected the importance Beijing attached to acquiring and understanding Western technology. Moreover, Beijing announced that it would honor the international patent protection agreement, a policy totally at variance with Maoist orthodoxy, which insisted that all knowledge should be part of the public domain.

These policies provided a more favorable climate for trade, helping to stimulate both exports and imports. With prices stabilizing, exports increased steadily throughout the year, a full 24 percent in real terms. Imports recovered even more dramatically from the depressed level of 1977, jumping 51 percent in real terms. Imports of industrial supplies, particularly steel and aluminum, increased the most, followed by a big boost in deliveries of capital goods. During 1978 alone, more than 500 Chinese delegations traveled to Western countries to shop for industrial equipment and technology.

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[5] In a hurried move to capture a share of what appeared to be a booming market for industrial plant and technology, both France and Britain began talks with the Chinese to arrange their own "Long Term Trade Agreements." The Chinese, for their own reasons, were happy to oblige. Unlike the association of private Japanese firms which negotiated the Sino-Japanese agreement, the French and British governments had no authority over the purchasing or sales decisions of individual corporations and could not set quantitative targets for trade in specific commodities. The negotiations bogged down over questions such as market disruption and when signed (the French in December 1978; the British in April 1979), merely called for the parties to strive to expand total two-way trade over the period through 1985 to a targeted level. The Chinese promised to give "preference" to French and British firms on certain projects in which they had shown interest; in return the Chinese received assurances that the other side would make "best efforts" to balance trade. More importantly, however, the Chinese obtained commitments from the British and French governments to make officially backed export credits available for Chinese purchases.

The enticement of a vast China market undoubtedly played a role in the U.S. decision to recognize Beijing as the government of China, a shift which was announced in December 1978. U.S. agricultural exports—led by wheat, corn and cotton—had jumped several fold during the year as China shifted purchases away from its traditional suppliers. This vaulted the U.S. into third place, behind Japan and West Germany, as a supplier to China. From its viewpoint, Beijing saw the U.S. not only as the most important source of agricultural commodities and advanced technology but also as a largely untapped market for its exports. Before trade could realize its full potential, however, several outstanding legal issues would have to be settled: lack of MFN-status for Chinese exports, unresolved frozen claims and assets, and lack of eligibility for U.S. Export-Import Bank financing of Chinese purchases. Once diplomatic relations were established, these constraints would be removed quickly.

With the establishment of Sino-United States diplomatic relations just around the corner, Beijing had laid much of the groundwork for a take-off of technology imports. After nearly a year of negotiations with the Japanese, however, they still had not come to terms on interest rates. Events in December, therefore, were entirely unexpected. In the space of 10 days the Chinese went on a buying spree and signed nearly $3 billion in whole plant contracts, bringing the total signed by the end of 1978 to over $7 billion. This year-end rush may have been related to another event during the month—the Central Committee Work Conference. Just as the Chinese were about to launch one of the largest transfers of technology in world history, they began a somber reappraisal of the plan's feasibility. It was at the Work Conference that the Chinese leadership announced its decision to institute a policy of "readjustment, reform, consolidation, and improvement." In their eagerness to insure that their own projects would not be affected by the retrenchment, some officials hurried to sign contracts before the order to suspend negotiations came into effect.

B. The Readjustment of 1979

1979 was a year of adjustment for Chinese foreign trade and for the economy as a whole. The year opened with considerable confusion in the trade bureaucracy. Record fourth-quarter 1978 and first-quarter 1979 current account deficits strained hard currency reserves. China's trade balance, which had been running in surplus through the first three quarters of 1978, turned into a $400 million deficit in the fourth quarter (measured on an f.o.b. basis), then plunged to a $700 million deficit in the first quarter of 1979—the largest quarterly deficit the Chinese had ever seen. On top of these accumulating trade deficits, the Chinese had obligated themselves to make downpayments of approximately $600 million for plants ordered in the second half of 1978. The signing in 1978 of $7 billion in cash contracts had left Beijing dangerously low on foreign exchange; reserves had fallen to less than $2 billion by the beginning of 1979.

Reacting to a rapidly deteriorating foreign exchange situation as well as to a general rethinking of China's development strategy, in

February 1979 the Ministry of Finance sent notice to 20 Japanese firms that contracts they had signed with China's National Technical Import Corporation (TECHIMPORT) had failed to receive Bank of China approval. As a result, the contracts—valued at $2.6 billion—were suspended while China reexamined the projects and the financial commitments associated with them. Simultaneously, the Ministry of Finance also ordered a moratorium on any major new contract signings.

While the moratorium on new contracts originated from the decision to readjust the economy taken two months earlier, the suspension of Japanese contracts was not primarily related to that campaign. Instead, international financial concerns appear to have been the driving force behind this first wave of suspensions.

Immediately following the suspensions the Chinese relayed the message to the Japanese Long-term Trade Consultation Committee that before China would reinstate the contracts the Japanese would have to provide U.S. dollar loans to finance the plants.[6] Moreover, the Chinese demanded that payment for the plant purchases, originally designated to be made in Yen, should be shifted over to payment in dollars.

In response, Japanese commercial banks arranged two syndicated Eurodollar credits, including a $2 billion line of credit for 4½ years, and a $6 billion 6-month revolving credit. Although bargaining was intense over the interest rates to be charged, the Japanese banks finally conceded to a rate of ½ percent over LIBOR (London Interbank Offer Rate) after the Chinese appeared to have succeeded in obtaining that rate—normally reserved for only the banks' best customers—from the French Bank, Union des Banques Arabs et Francoise (UBAF). In order to sweeten the pot, Japanese industrialists convinced the government to extend a 420 billion yen credit line (worth U.S. $1.8 billion at the time) from Japan's Export-Import Bank directly to the Bank of China for natural resource development projects—projects not covered within the scope of the LTTA. The yen loans would draw interest at 6¼ percent per year and provide up to 15 years for repayment.

After lining up the $8 billion in syndicated Eurodollar credits the Chinese immediately renegotiated the suspended contracts to place them on a dollar payment basis. By July, all of the contracts, except one for a 300,000 ton-per-year ethylene plant, had been reinstated. Ironically, the Chinese have never used this Eurodollar facility. Between May and August 1979, LIBOR rates climbed from 10½ percent to 17 percent and the Chinese continued to pay cash on delivery of the plant and equipment.[7] In addition, as a result of excellent export growth, China's trade balance improved dramatically over the next year, leaving little need for the credits.

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[6] The date on which the suspension notices were sent out—16 February—was important in two respects: first it fell just within the 60 day time limit prescribed by escape clauses in the Japanese contracts, during which the Bank of China could review the contracts prior to making downpayments. Second, but more importantly, it fell one year to the day after signing of the Sino-Japanese Long Term Trade Agreement—a coincidence intended by Beijing to signal China's exasperation with Japan's intransigence on providing financing for these major purchases.

[7] The Boashan steel mill contract was the sole exception. Nippon Steel agreed to accept payments half in yen and half in dollars with, at least, the yen portion on a deferred payment basis.

While the Japanese contract suspensions were primarily a Chinese gambit to pressure the Japanese into providing long-promised credits, the Chinese placed a halt on new contract signings in order to give themselves time to reassess their development strategy. At the time, however, the Chinese probably did not foresee a major cutback in investment spending. Throughout 1979 they continued to arrange large lines of credit in anticipation of major capital purchases to follow. Thus by the end of 1979 the Chinese had amassed over $17 billion worth of officially supported export credits from France ($7.3 billion), the United Kingdom ($5 billion), Japan ($1.8 billion), Canada ($1.7 billion) and Italy ($1.0 billion), with smaller amounts from Belgium, Sweden, and Australia; and over $10 billion worth of commercial credits.

In the early months of 1979, Beijing took several corrective measures that affected whole-plant purchases. The first was a reordering of investment priorities. Agriculture, light industry, power, building materials, and transportation were identified as needing greater investment, at the expense of heavy industry, especially steel. Major organization changes also were made as Beijing began to delegate decisionmaking authority to lower levels. Provincial- and municipal-level organizations which had been negotiating small plant contracts were instructed to raise their own financing and assume responsibility for the profitability of their investments. Higher level organizational changes also were made. The Bank of China, for example, was separated from the People's Bank to tighten control over foreign exchange reserves. In addition the Foreign Investment Control Commission was established to control foreign currency borrowing. The changes were intended to prevent a financial crisis similar to the one that occurred in February.

The Chinese also began to rethink their export policies. Articles in the Chinese press extolled the virtues of the economies of Japan, South Korea, and Taiwan—countries which developed through promotion of export industries. Chinese economists called for the country to specialize along lines of comparative advantage—in labor-intensive industries—in order to maximize the gains from trade. By diverting funds from heavy industry to light, the Chinese expected to reap a larger return on investment, and in much less time.

These new policies were endorsed at the June meeting of the National People's Congress, during which the leadership strongly reaffirmed decisions taken over the previous two years to liberalize and expand foreign trade. The Congress ratified the decision to pursue further decentralization of the foreign trade structure, permitting local production units to retain a share of their export profits. And by passing China's first Joint Venture Law, the Congress showed an unprecedented willingness to foster direct foreign investment.

Although doubts about the efficacy of the joint venture law prevented any meaningful foreign investment in China during 1979, a major benefit of the law was to provide reassurance to Western oil companies of China's intent to establish a legal basis for their relationships. Negotiations with Western oil companies were among the few that continued unaffected during the early months of 1979. In April letters of intent were signed with several US companies for seismological studies in the South China Sea and negotiations continued with French, Italian, and British firms for similar work in the Yellow and East China Seas. Finally, in December 1979 the China National Oil Corporation signed an agreement with Japan's National Oil Company (JNOC) for joint exploration and development of the Bohai Gulf. Under the agreement the JNOC would provide funds for most of the $250 million exploration effort and an additional $500 million for expected development costs. China would draw $500 million from Japan's Export-Import Bank resource development credit to cover all but $20 million of its share. The agreement gave JNOC rights to 42.5 percent of any oil produced over the next 15 years.

For the year as a whole, contract signings for major plant and equipment purchases dropped to $2 billion. When negotiations resumed in midyear, they reflected Beijing's new priorities. Discussions on thermal and hydropower projects headed the list. But foreign steel firms that in late 1978 had been negotiating contracts worth more than $20 billion were informed that most of these projects were being shelved indefinitely. Beijing also began seeking foreigners willing to purchase equity shares in light industry projects under the new joint venture law.

C. The Decentralization Movement—1980

For 1980 as a whole China's foreign trade growth reached record levels. Exports during the year shot up 42 percent over the 1979 total to $19.6 billion, while imports jumped 36 percent to $19.3 billion. Much of the increase may be attributed to China's decision, taken in 1978 and reaffirmed in 1979, to decentralize the foreign trade apparatus. By permitting local enterprises to engage in trade directly with foreigners, Beijing unleashed a large demand for Western capital and consumer goods and provided incentives, where none had previously existed, for individual enterprises to market their products abroad. Decentralization, however, also had some serious side affects, which by year-end brought into question the compatability of a mixed, part-plan, part-market economic system.

During 1980 Beijing gave increasing authority over foreign trade matters to individual production units. This was part of Beijing's overall policy of decentralization—individual production units were made accountable for their own profits and losses in order to improve the "rationality" and efficiency of the economic system. The limited ability of the Ministry of Foreign Trade and its foreign trade corporations to handle the increasing volume and complexity of trade was another factor behind Beijing's move.

In order to make the decentralization of foreign trade palatable to the individual production units, Beijing provided two enticements. One was a decision to allow municipal and provincial export enterprises to retain up to 30 percent of their foreign exchange earnings for their own use, rather than requiring them to remit all foreign exchange to the state. The second was a decision to permit these enterprises to convert foreign exchange earnings into yuan at a more favorable rate than the official Bank of China rate. The more favorable rate was called the "exchange rate for internal settlement."

Given a vast pent-up demand for foreign capital and consumer goods and a lack of domestic investment funds resulting from the state's decision to discontinue subsidies to production units, local enterprises in the maritime provinces responded enthusiastically to these incentives, entering into processing arrangements and compensation trade deals and, in a few instances, forming joint ventures with foreign firms.[8] In 1980, perhaps as much as $3-4 billion in trade was conducted by these enterprises—outside the purview of the Foreign Trade Corporation.

While the decentralization measures directly stimulated exports, they also created some severe problems for Beijing. One of the most difficult problems was the lack of control over foreign exchange expenditures. Allowed to retain a share of their foreign exchange earnings, provincial and local export enterprises syphoned off hard currency earnings that could have been used by the central government. Many enterprises deposited these funds in Hong Kong, beyond supervision by the Bank of China. This practice gave Chinese firms immediate access to foreign exchange for their purchases without the red tape which normally accompanied import decisions. It also hindered the ability of central authorities to formulate trade plans and to regulate foreign exchange flows.

The lack of control over expenditures became most apparent during the fourth quarter, when a surge in imports resulted in a deficit of over $300 million—the first trade deficit since early 1979. The hard currency outflows caught Beijing by surprise, and in November China withdrew its reserve tranche of $280 million from the International Monetary Fund, the first drawing since China's entrance into the IMF in May. The imbalance continued into the first quarter of 1981 and by the end of March Beijing had gone to the well for a total of $1.1 billion, exhausting its first credit tranche. China also drew heavily on short-term foreign commercial loans during this period.

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[8] Efforts to attract Western companies to purchase equity ownership in Chinese enterprises bore fruit in the first quarter of 1980, eight months after the National People's Congress gave its formal approval to the joint venture law. The deals concluded were for a catering service which prepared food for flights out of Beijing's International Airport, a joint shipping venture, two elevator plants, and a luxury hotel in Nanjing. In May Beijing signed two contracts with French Firms—Total and Societe Nationale Elf Aquitane—for joint exploration and development of China's offshore oil resources in the eastern and northeastern Bohai, with terms similar to the JNOC contract.

Although many of the early joint ventures encountered problems that could be expected to plague any new form of business arrangement, Beijing took steps in August and September to eliminate some of the most glaring problems. These steps included the adoption of regulations to control foreign investment in the Special Economic Zones in Guangdong and Fujian and the approval of regulations on foreign exchange loans to enterprises. Most importantly, the National People's Congress promulgated income tax and joint venture tax laws, which helped to remove some of the uncertainties facing foreign firms in making a decision on whether to invest in China.

According to a Chinese report in Economic Reporter English Monthly, December 1980, p. 36, by the end of 1980 the Chinese had signed 17 agreements for joint ventures inside China, four contracts for joint-exploration of offshore oil and 289 cooperative projects and joint ventures in other countries with a total investment of $1.8 billion. In addition to the joint ventures mentioned above, ventures inside China included a pig farm, a winery, a leasing company, several hotels, and factories to produce woolen textiles, artificial flowers, furniture, optical goods, batteries, televisions, and watch dials. Ventures outside China included businesses such as a joint finance company in Hong Kong between the Bank of China, the First National Bank of Chicago, and the Industrial Bank of Japan, and joint construction companies operating in third world countries using Chinese laborers and western technologies. During 1980 the Chinese also signed about 2,000 agreements for processing and assembling foreign materials and parts.

Faced with these difficulties, the government felt its only course would be to return at least part way to a more centralized management of foreign trade. In December the State Council promulgated exchange regulations that put the Bank of China firmly in control of all foreign exchange transactions. In particular, the law required any Chinese organization holding deposits in foreign banks to remit all such funds to the Bank of China by March 1, 1981. Beijing also officially pegged the "internal exchange rate" at 2.8 yuan per dollar in part to discourage imports by local production units. At the same time, Beijing gave the Foreign Trade Corporations full authority over many commodities which had previously slipped into the hands of the localities.

D. Reconciling Readjustment and Reform—1981

From the viewpoint of a foreign trader, 1981 began on a sour note. In February Beijing unilaterally cancelled contracts worth nearly $2 billion for the second phase of the Baoshan steel mill, four petrochemical complexes, and a copper refinery. The cancellations affected not only the Japanese, but West German, British and American firms as well.

On the surface, this wave of cancellations had several parallels with the first wave of February 1979, but in fact the root causes ran far deeper. Not until 1980 did Beijing begin to realize the severity of imbalances developing in the domestic economy. Investment spending was badly overextended, resulting in a budget deficit of 12 billion yuan for the year. Domestic expenditures on construction of plants purchased overseas contributed significantly to the deficit. On top of this, Beijing was forced to lower its expectations for oil output. Official statements suggested that China would do well just to maintain the current rate of production through the mid-1980s, rather than doubling output as originally planned. The lack of projected energy supplies for the Baoshan steel mill and of petroleum feedstocks for the petrochemical plant complexes were among the major factors leading to their cancellations.

Although China's trade balance declined sharply immediately preceding the cancellations, contrary to much speculation in the Western press, the Chinese did not lack foreign exchange to pay for the plants. China's hard currency reserves were adequate and earnings more than sufficient to make scheduled payments. When the Chinese sent notice of the cancellations they also gave assurances that they would remunerate firms for any losses "according to international practice." Thereafter, the Chinese continued to accept delivery of the equipment, paying for each shipment in cash. Most deliveries have now been completed. As in 1979, the Chinese again told the Japanese that in order to reinstate any of the cancelled contracts, they would need low interest loans. Unlike China's earlier loan request, however, the new loans would be to cover the local costs of the project—a source of much confusion in the Western press. In effect, the Chinese wanted to finance their domestic budget deficits with foreign loans.

From commentary in the Chinese press[9] one can infer that a lengthy debate took place within the leadership before the decision to cancel the contracts. The debate focused on the question of whether readjustment should take precedence over reform. Those favoring readjustment argued that to stem overexpenditure on investment by local enterprises and prevent a further deterioration in the domestic budget, it would be necessary for the government to postpone many of the reforms initiated in 1980. The readjustment view prevailed. As of mid-1981 the Ministry of Foreign Trade had regained authority over many commodities which had been lost to producers the year before. But the reform movement clearly was not dead. It had attracted many followers who had a real stake in trade with the West.

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[9] See example, FBIS, Daily Report, China, November 10, 1980, pp. L14-18.

IV. CURRENT POLICY PROBLEMS

Almost all of the policy changes instituted over the past three years have fallen under the rubric of either economic readjustment or economic reform. Under the readjustment program China's macroeconomic goals were to undergo a complete reevaluation. Investment was to be scaled back in favor of more consumption; and heavy industry, the focus of both trade and domestic economic policy at the time, was to be deemphasized in favor of light industry and agriculture. The reform program, on the other hand, was to tackle microeconomic-type problems. Profitability was to become the major standard by which many of China's enterprises, including those engaged in foreign trade were to be evaluated.

A. *Impact on the West*

The sweeping changes in foreign trade policies that accompanied China's readjustment program were generally applauded in the West, although they brought large cutbacks in major capital purchases. The new effort to build up the light industrial and agricultural sectors, long thought to be areas where Beijing's comparative advantage was greatest, were well received. That Beijing was setting aside an extended time period to reexamine the direction of its overall economic policy was also viewed as a positive step. In addition, the new emphasis on exports and Beijing's reaffirmation that despite its cutback in the import of capital goods it would continue to emphasize foreign trade, all helped boost Western confidence in China.

Much of the initial enthusiasm for the readjustment policy, however, dissipated as a result of the erratic measures taken by Beijing to implement the program. Certain contracts for Japanese petrochemical equipment, for example, were initialled by TECHIMPORT in December 1978, suspended less than two months later, reinstated at the original terms by midyear only to be cancelled again in February 1981. Even after the final cancellation Beijing continued to accept delivery of equipment and to make payment under the terms of the original contracts. The Japanese were not the only firms affected by such erratic behavior. West German, American, and British companies all had contracts summarily cancelled by Beijing as a result of the readjustment.

The introduction of the economic reform package with its emphasis on measuring results in terms of profits and losses further clouded the trade picture. While the overall goal of the program was to push decisionmaking authority down to local levels, the lines of authority were not clear-cut. Some goods remained the exclusive domain of the Ministry of Foreign Trade while, for other products, local authorities were granted greater autonomy. As a result, not only were foreign businessmen unable to count on traditional lines of authority but in many cases even the Chinese were unclear as to where the final authority for various trade matters rested. In one case, for example, a foreign firm seeking to build a hotel in a major Chinese city spent long hours coming to terms with representatives of the MFT only to have the project disapproved by the local authorities who had final authority over the use of the land where the hotel was slated to be built.

B. Impact on China

Western firms were not alone in suffering ill effects from the policy changes. China was also experiencing difficulties. China's terms of trade, a key indicator used by planned economies to determine the efficacy of trade, began to deteriorate as local traders bid export prices down and import prices up. Some of China's large, efficient, export enterprises also began having problems. Under the previous tightly controlled planning system these enterprises drew resources from various localities and processed them in bulk for export abroad. After decentralization, local authorities, eager to take advantage of their newly found ability to generate foreign exchange, began setting up their own smaller-scale, competing enterprises. Scarce local resources once channelled to more efficient enterprises were siphoned off to smaller local facilities and excess capacity in some areas began growing rapidly.

Financial problems also sprang out of the decentralization effort. When Beijing gave approval for local enterprises to retain certain shares of their foreign exchange profits, government authorities assumed that all of these funds would be deposited in the Bank of China (BOC). While this procedure may have been followed in the early stages, Chinese exporters soon found their foreign exchange funds more accessible and more profitable when held in banks outside China. By yearend 1980, when orders were issued to repatriate all funds held in this form abroad, perhaps as much as $1 billion in foreign exchange had slipped outside Beijing's grasp.

Of all the difficulties associated with the reform movement, however, the one probably most responsible for Beijing's decision to shelve the program was its conflict with economic retrenchment. When local enterprises that were slated to come under Beijing's budgetary axe began using the reform program to line up foreign equipment and funds to circumvent investment cutbacks, the program was destined for reappraisal.

C. The Underlying Economic Issues

Blame for much of the confusion that has resulted from the reform and readjustment measures undoubtedly rests with Beijing. The government has been guilty of moving too erratically to counter unforeseen problems arising in its foreign trade sector. With its statistical apparatus still in disarray from the Cultural Revolution, Beijing may have little idea of what the possible repercussions of many of its policies are. Beijing may also be attempting to implement economic policies it does not fully understand. Problems associated with the economic reform packages, for example, appear to stem from basic contradictions that arise in trying to take advantage of the market mechanism where market signals, i.e. prices, are confused. For the past 30 years Beijing has fixed domestic prices at somewhat arbitrary levels rather than allowing them to reflect supply and demand. As a result, efforts to encourage traders to become more profit motivated have in many cases yielded perverse results. In a very real sense, profitability is not defined by the interrelationship between supply and demand, or by the efficiency with which the firm is run, but rather by the level at which Beijing sets input and output prices. Moreover, Beijing was unaware of the tradeoffs associated with various economic policies in a market system. While explicitly giving firms a certain amount of leeway to expand or contract operations according to their profitability, Chinese authorities proved unwilling to allow expansion outside those industries that they had separately designated for emphasis. Citing inflationary pressures, the government also quickly supressed the competitive price bidding that arose as soon as firms were given responsibilty for their own profits. Unwilling to sacrifice its macroeconomic goals on the altar of the market, Beijing had little choice but to backdown from its microeconomic reform program.

Although the Chinese may have shelved their experiment with the market mechanism for the time being, they continue to espouse its advantages for China and may attempt to readopt it. While continuing to express confidence in the market mechanism, however, Beijing has not yet shown signs of creating an environment where the market can operate freely. Throughout the difficulties in the conflict between readjustment and reform the subject of flexible prices has been blatantly supressed. Fear of resparking the hyperinflation of the 1940s in probably largely to blame for the current unwillingness either to allow prices to fluctuate or at least to adjust them to provide some indication of resource allocations.

Decentralization, in the absence of a rational price structure, will do very little to help Beijing determine where to channel scarce resources. Efficient factories may be forced to close under the current price structure while inefficient ones operate at sizeable profits. As a result, unemployment, and disparities in personal incomes that will inevitably accompany China's efforts to close inefficient factories and propagate efficient ones may come with almost no gains in productivity. In short, while a true market system might be of great benefit, it is not necessarily true that China's attempt to take advantage of a market where market signals are in disarray, will be any more beneficial to foreign trade and overall economic development than a tightly controlled foreign trade bureaucracy.

Although Beijing continues to face numerous foreign trade problems ~~the difficulties should be viewed in~~ light of the government's numerous success. Overall trade performance since 1978 has been excellent with exports growing at an average annual rate of 35 percent. The high priority assigned to foreign trade in recent years has given domestic traders a certain stability not present during the preceding 30 years. In addition, decentralization measures have made producers of export goods mindful of problems that prior to decentralization seemed to defy solution. Chinese exporters for the first time appear to be making real headway improving product quality, meeting Western packaging standards, and adhering to delivery schedules.

Much of the thrashing about of trade policy in the past few years can be explained by recognizing China's unique position as a centrally planned economy (CPE) forced to deal almost entirely in the World market. For the Soviet bloc countries, where CPE's trade heavily among themselves, the inability to adjust to the constantly changing conditions of a market creates few major problems. For China, however, where less than 10 percent of its total trade is carried out with other tightly planned economies, the temptation to respond to market changes is much greater. In part, this explains China's determination to carry through with decentralization despite the difficulties encountered in the past. With trade growing at record rates, and almost all of it taking place in a world market environment, the tightly controlled foreign trade organization of the past is probably incapable of meeting China's present needs.

V. TRADE PROSPECTS FOR THE 1980's

Forecasts of future trends in China's trade must be tentative, because of the uncertainty over how Beijing will resolve the crucial issue of the relationship between central planning and the market mechanism. On the one hand, if China returns to a more centralized system of foreign trade, we would expect to see a more temperate pace than in the period from 1977 to 1980. On the other hand, if China gives freer rein to market forces, trade could take another leap forward, driven by years of pent-up demand.

A. Export Prospects

Success in expanding exports will depend largely on China's ability to follow up on the reform measures of the recent past and to move swiftly into export lines that emphasize the country's greatest comparative advantage—large masses of low-wage laborers. China currently exports a wide variety of agricultural and mineral products and relatively simple, inexpensive manufactured goods. Agricultural and mineral product exports will likely be limited by domestic supply and demand constraints whereas rapid increases in exports of some manufactured goods are likely to be held back by restraints on foreign demand. Beijing has, however, demonstrated an ability to penetrate manufactured product markets in short order. In textiles, for example, Western quota's on certain Chinese exports have caused almost immediate shifts into unrestricted goods. With only about ½ percent of all Western imports coming from China, considerable potential exists for developing new export lines, especially if more export processing zones are established.

Agricultural exports have grown at a considerably slower rate than exports in general in the 1970s and are likely to continue to do so. Growth has been particularly slow since 1974. The share of agricultural exports thus has dropped from nearly 50 percent in 1970 to less than 30 percent in 1979. Important export items include meat, fish, fruits, and vegetables, the primary market for which is Hong Kong. Prospects for rapidly increasing these exports are not good. The Hong Kong market where Chinese products have a considerable competitive edge is pretty well saturated.

Oil has set the pace for extractive exports in the 1970s, rising from nothing in 1970 to 256,000 b/d in 1980. Oil revenues amounted to $2.8 billion in 1980 or 14 percent of total export earnings. Most of the oil is purchased by Japan but several other countries, including the United States take smaller amounts.

Supply problems in China bode poorly for future gains in crude oil exports. Output levelled off at about 106 million tons in 1980 and may fall by as much as 6 percent this year. Although attempts to shift energy consumption toward coal may provide short term gains, it is unclear how effective these measures will be in the long run. In the meantime, Beijing will probably attempt to hold exports at about the current level over the next few years in order to avoid any sharp declines in foreign exchange earnings. Potential after 1985 depends heavily on China's success in its offshore oil exploration program. Japanese and French companies are already exploring for oil and US firms should sign exploration contracts later this year.

Coal and other mineral exports increased fairly slowly in the 1970s but have gained steam in the last few years. Coal shipments to Japan are slated to increase quite sharply under terms of the Long Term Trade Agreement, from 500,000 tons in 1978 to 3.5 million tons in 1982. Tokyo and Beijing are currently talking about boosting shipments to 10 millions tons in 1985. Even with the sharp increases, coal exports will continue to account for less than 5 percent of total exports. Beijing is also stepping up shipments of tungsten, talc, titanium, and aluminum but earnings from these commodities make up less than one percent of total foreign exchange revenues.

The main thrust of a Chinese export drive will have to be in manufactured goods. Exports of manufactured goods have expanded at an annual rate of approximately 17 percent in real terms since 1970, rising to more than 50 percent of total exports. A continuation of high industrial growth rates, combined with more emphasis on exports and a strong shift into higher valued export lines, should enable China to maintain past growth rates in foreign sales. As with many other emerging nations, textiles are playing a leading role in Chinese exports. Textile and clothing exports totalled $3.3 billion in 1979—24 percent of total Chinese exports. Textile exports have grown at an even faster rate than overall exports over the past few years. Textile and clothing production is expected to increase rapidly aided by the output of several major imported synthetic fiber plants. Low-cost labor if accompanied by modern production techniques and marketable designs could provide the PRC a competitive edge. The major problem in rapidly expanding textile exports will be that of breaking into already highly protected markets. Beijing may have some advantage in that its textile exports are currently widely distributed, with LDC's purchasing over 40 percent of textile fabric and clothing exports, whereas entry into the more profitable North American and West European markets has only just begun. Beijing probably will attempt to squeeze the developed market shares of East Asian rivals—Hong Kong, South

Korea, and Taiwan—and to seek lower tariff and nontariff barriers for its products. Given the likely import restrictions, however, growth in future textile exports will depend on Beijing's ability to move into new, unrestricted, product lines.

Other important manufactured exports currently include iron and steel, mineral and metal products, machinery, and transportation equipment (all shipped primarily to LDC's) and handicrafts (shipped to developed countries and Hong Kong). With the exception of iron and steel, all of these areas have recently been focused on as having significant export potential. Efforts are now underway to gear China's machine tool industry toward exports to LDCs. Hand tools, hardware, and other metal products are also slated to increase. Exports of machinery and equipment, including trucks, ships, and military goods—again primarily for LDC's—will probably also pick up speed. Even in the area of power generation, China has already had some success marketing equipment for small hydroelectric projects in the Philippines and South America.

B. Import Prospects

Pessimism is probably the best way to characterize the current attitude in the West with regard to selling a huge amount of capital equipment to China. This attitude is probably realistic. China has neither the resources nor the technical expertise required to undertake a program of high technology assimilation expected by many Western traders in 1978. To the extent that it stems from a belief that the China market as a whole is drying up, however, the pessimism is unfounded.

Export growth remains the key to China's willingness to import. Although the ongoing experiment with decentralization has taken some control over exports and imports out of the hands of the central authorities, Beijing will continue to take steps to counter any large trade deficits. Small deficits can be expected. China has demonstrated an eagerness to take advantage of long-term, low interest loans, a trend that will undoubtedly continue in the future. But Beijing's refusal to utilize major commercial loans at current market rates for anything other than short term exigencies is a clear indication that it expects trade to remain near balance. Even for normal trade financing Beijing is attempting to rely more heavily on compensation deals and processing arrangements to bring in raw materials and machinery and equipment with no accompanying outlay of foreign exchange. With the government's commitment to keep a tight rein on debt exposure, the debt service ratio will probably be held to less than 15 percent over the next few years.

The priorities of the readjustment program will continue to determine the commodity composition of trade. Agricultural imports, especially grain and cotton, will probably become increasingly important as the Chinese attempt to improve their standard of living. Consumer goods, including TVs, radios, tape recorders and watches will also benefit. Although reluctant to see its scarce foreign exchange reserves go for such uses, Beijing's current overriding interest in consumer welfare ensures that this upward trend will continue at least in the near term. Over the longer run, China will probably attempt to become a net exporter of many of these goods. At that point, the Chinese will probably restrict imports to conserve foreign exchange and to guarantee a market for domestically produced consumer items. Beijing's willingness to import in order to expand exports could lead to sharp increases in purchases of semi-finished manufactured products.[10] Imports of plastic materials, chemical products, and electronic components, for example, should be up sharply in the next several years. Dyeing materials, yarn, and fabrics will also rise in importance as Beijing moves to boost its textile sales. With construction of several major petrochemical projects delayed as a result of the readjustment program, synthetic fiber imports should also become increasingly important. Efforts to improve the quality of China's packaging for export have already led to sharp increases in purchases of wood pulp and paper products, a trend likely to continue as exports rise.

Much of the upward pressure on China's import bill for agricultural products, semi-finished manufactures, and consumer goods will be offset by steep declines in major plant purchases. The drop-off, part of Beijing's commitment to scale back capital construction, will be especially pronounced in 1981. The $9 billion in whole-plant contracts signed in 1978–79 led to record machinery and equipment deliveries last year. With delivery completed on most of the earlier contracts, and with the recent cancellaton of major 1980 contracts, imports should taper off sharply by yearend and remain low for several years. Iron and steel imports in the next few years also will probably remain low, below the 3.8 million tons purchased in 1980.

Although machinery and equipment imports on the whole will be down, in certain specific areas Chinese demand remains strong. Infrastructure projects, especially for transportation and power generation, will require occasional large purchases of machinery and equipment. Demand for coal-mining equipment should also remain strong. Beijing will undoubtedly utilize a great deal of western and Japanese oil drilling equipment in the near future but, at least for the offshore ventures, it is unclear whether the purchases will show up in China's import figures. Much of the equipment may be counted as the Western partner's share in the ventures rather than as a Chinese purchase.

Beijing's new import priorities bode well for major agricultural exporters, especially the United States. With increasing exports of grain and cotton, the United States could overtake Japan as China's largest supplier by 1985.[11] Hong Kong, with its ability to provide semi-finished products and the willingness of its businessmen to engage in all types of compensation and processing agreements, may also make major gains. The big losers in terms of the China market are likely to be the West Europeans. China's 1980 imports from Western Europe were down 13 percent compared to 1979 largely because of falling steel purchases. With machinery and equipment imports also destined to suffer, purchases from Western Europe may decline even further. Japan's share in China's total imports may fall somewhat from the 26 percent share held in 1980 but its proximity to China, its ability to provide high quality, semi-finished materials and consumer goods, and its willingness to meet Chinese financing needs, guarantees Tokyo a solid position as a major supplier to the PRC.

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[10] In the pre-1976 era eports were viewed strictly as a source of foreign exchange for imports. Anyone advocating the use of exports for other reasons was subject to criticism for "sellingout" to capitalists.

[11] Although, to date, Beijing appears to be completely uninhibited in it purchase of U.S. goods this trend is unlikely to continue if the bilateral trade deficit continues to widen. In 1980 Chinese imports from the U.S. exceeded exports by $2.7 billion, about three times larger than its deficit with any other country.

APPENDIX A.—TRADE TABLES

TABLE A-1.—CHINA: BALANCE OF TRADE [1]

[In millions of U.S. dollars]

	Total trade				Communist countries				Non-Communist countries			
	Total	Exports	Imports	Balance	Total	Exports	Imports	Balance	Total	Exports	Imports	Balance
1950	1,210	620	590	30	350	210	140	70	860	410	450	−40
1951	1,900	780	1,120	−340	975	465	515	−50	920	315	605	−290
1952	1,890	875	1,015	−140	1,315	605	710	−105	575	270	305	−35
1953	2,295	1,040	1,255	−215	1,555	670	885	−215	740	370	370	0
1954	2,350	1,060	1,290	−230	1,735	765	970	−205	615	295	320	−25
1955	3,035	1,375	1,660	−285	2,250	950	1,300	−350	785	425	360	65
1956	3,120	1,635	1,485	150	2,055	1,045	1,010	35	1,065	590	475	115
1957	3,055	1,615	1,440	175	1,965	1,085	880	205	1,090	530	560	−30
1958	3,765	1,940	1,825	115	2,300	1,280	1,100	1,80	1,385	660	725	−65
1959	4,290	2,230	2,060	170	2,980	1,615	1,365	250	1,310	615	695	−80
1960	3,990	1,960	2,030	−70	2,620	1,335	1,285	50	1,370	625	745	−120
1961	3,015	1,525	1,490	35	1,685	965	715	250	1,335	560	775	−215
1962	2,670	1,520	1,150	370	1,410	915	490	425	1,265	605	660	−55
1963	2,775	1,575	1,200	375	1,250	820	430	390	1,525	755	770	−15
1964	3,220	1,750	1,470	280	1,100	710	390	320	2,120	1,040	1,080	−40
1965	3,880	2,035	1,845	190	1,165	650	515	135	2,715	1,385	1,330	55
1966	4,245	2,210	2,035	175	1,090	585	505	80	3,155	1,625	1,530	95
1967	3,915	1,960	1,955	5	830	485	345	140	3,085	1,475	1,610	−135
1968	3,785	1,960	1,825	135	840	500	340	160	2,945	1,460	1,485	−25
1969	3,895	2,060	1,835	225	785	490	295	195	3,110	1,570	1,540	30
1970	4,200	2,155	2,045	110	870	480	390	90	3,330	1,675	1,655	20
1971	4,680	2,535	2,145	390	1,100	585	515	70	3,580	1,950	1,630	320
1972	5,805	3,220	2,585	635	1,290	735	555	180	4,515	2,485	2,030	455
1973	9,725	5,100	4,625	470	1,710	1,000	710	290	8,020	4,100	3,920	139
1974	13,545	6,735	6,810	−75	2,410	1,445	965	475	11,135	5,290	5,845	−589
1975	13,955	7,130	6,825	305	2,375	1,370	1,005	365	11,585	5,765	5,820	−69
1976	12,835	7,270	5,565	1,705	2,310	1,230	1,080	150	10,530	6,040	4,490	1,559
1977	14,680	8,090	6,590	1,500	2,420	1,355	1,065	285	12,260	6,735	5,525	1,215
1978	20,405	10,085	10,320	−285	3,100	1,565	1,535	25	17,305	8,520	8,785	−248
1979	28,000	13,720	14,285	−565	3,540	1,700	1,840	−140	24,455	12,015	12,440	−495
1980	38,940	19,590	19,350	240	3,880	1,945	1,935	10	35,055	17,640	17,415	230

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[1] Data are rounded to the nearest $5,000,000. Because of rounding, components may not add to totals shown. Data for 1950–1969 are from Batsavage, R.E., and Davie, J.L. "China's International Trade and Finance," in U.S. Congress, Joint Economic Committee," Chinese Economy Post-Mao," Vol. 1, November 9, 1978, p. 733. For those years exports are valued free on board (f.o.b.) at the point of origin, and imports are valued on a cost, insurance, and freight (c.i.f.) basis at Chinese ports. Beginning with the year 1970 imports are also valued f.o.b. at port of origin. Data for 1970–1980 are from Central Intelligence Agency, National Foreign Assessment Center, "China: International Trade," various issues.

TABLE A-2.—CHINA: EXPORTS, F.O.B., BY AREA AND COUNTRY [1]

[In millions of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
World	2,156	7,131	7,270	8,089	10,086	13,718	19,588
Non-Communist countries	1,676	5,764	6,041	6,736	8,522	12,018	17,642
Developed countries	658	2,610	2,697	2,939	3,776	5,643	8,263
East Asia and Pacific	282	1,555	1,422	1,631	2,107	2,993	4,422
Australia	35	86	100	124	140	166	244
Japan	242	1,457	1,307	1,486	1,948	2,793	4,139
North America	18	211	291	280	406	737	1,188
Canada	18	55	90	77	83	143	132
United States		155	202	203	324	594	1,056
Western Europe	358	844	984	1,028	1,262	1,912	2,652
Belgium	9	39	46	35	39	67	165
France	61	151	169	169	196	284	406
West Germany	73	194	236	250	319	464	703
Italy	55	112	135	142	174	344	380
Netherlands	23	70	78	82	109	136	237
Spain	1	20	41	36	59	115	102
Sweden	16	41	44	51	48	68	93
Switzerland	16	27	31	34	44	48	67
United Kingdom	70	115	136	159	186	255	316
Less developed countries	1,018	3,154	3,343	3,797	4,747	6,375	9,380
Southeast Asia	715	2,111	2,288	2,512	3,197	4,271	6,285
Hong Kong	467	1,372	1,593	1,735	2,249	3,021	4,401
Indonesia	31	194	126	146	116	125	189
Malaysia	71	142	128	134	211	212	241
Philippines		48	54	79	112	121	210
Singapore	120	272	254	262	326	392	599
Thailand		16	68	64	80	230	396
South Asia	73	146	78	103	158	263	321
Bangladesh		2	8	18	42	65	76
Pakistan	26	51	61	52	79	117	160
Sri Lanka	46	89	6	30	28	64	49
Middle East	77	399	432	592	565	762	1,088
Iraq	22	65	54	82	60	83	121
Kuwait	19	47	71	124	92	125	198
Saudi Arabia		4	16	31	90	128	215
Syria	8	39	31	43	47	47	40
United Arab Emirates	6	54	47	79	74	106	127
North Africa	43	92	132	145	167	174	277
Egypt	13	32	39	45	52	30	65
Libya	9	10	59	47	51	70	102
Sub-Sahara Africa	102	365	363	377	533	619	882
Nigeria	18	63	128	133	187	260	378
Sudan	11	42	25	27	47	44	65
Tanzania	34	71	38	17	35	34	50
Zambia	3	26	13	8	8	2	
Latin America	7	42	50	67	126	286	527
Argentina	1	1		1	2	11	32
Brazil		1			4	86	239
Chile				9	11	24	29
Mexico		8		8	27	40	63
Peru		1	1	1	10	14	20
Communist countries	480	1,368	1,229	1,354	1,563	1,700	1,946
U.S.S.R	22	150	178	178	257	241	230
Eastern Europe	255	623	541	706	982	1,076	1,306
Czechoslovakia	25	58	56	89	136	117	170
East Germany	36	103	96	110	138	190	276
Hungary	11	48	27	36	66	53	59
Poland	24	43	40	54	91	105	129
Romania	62	215	202	273	415	524	585
Yugoslavia	2	16	15	36	70	48	49
Other	203	595	510	470	324	384	410

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[1] Data are reconstructed from various issues of Central Intelligence Agency, National Foreign Assessment Center, "China: International Trade". Data are rounded to the nearest $1,000,000. Components may not add to total because of rounding. Only major trade partners are shown within any trade region. Area totals are based on reporting by 159 trade partners.

TABLE A-3.—CHINA: IMPORTS, F.O.B., BY AREA AND COUNTRY [1]

[In millions of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
World	2,044	6,826	5,566	6,590	10,321	14,283	19,348
Non-Communist countries	1,655	5,822	4,488	5,523	8,784	12,442	17,414
Developed countries	1,372	4,984	3,768	4,166	7,268	10,168	13,508
East Asia and Pacific	702	2,600	1,955	2,454	3,622	4,539	6,066
Australia	129	326	264	461	484	776	796
Japan	569	2,258	1,666	1,955	3,074	3,674	5,109
North America	135	674	335	518	1,307	2,230	4,497
Canada	135	370	200	346	442	507	742
United States		304	135	171	865	1,724	3,755
Western Europe	534	1,710	1,479	1,195	2,338	3,398	2,946
Belgium	23	47	40	48	205	129	104
France	81	373	355	95	199	339	303
West Germany	167	523	622	501	995	1,492	1,145
Italy	57	145	127	89	188	278	254
Netherlands	22	134	39	52	135	159	147
Spain	1	23	17	21	66	128	64
Sweden	22	41	31	45	83	114	83
Switzerland	21	57	52	57	95	119	139
United Kingdom	107	178	126	109	176	453	394
Less developed countries	283	838	720	1,357	1,516	2,274	3,906
Southeast Asia	55	189	220	442	387	883	1,956
Hong Kong	10	34	30	44	63	382	1,249
Indonesia							
Malaysia	22	52	45	120	110	182	217
Phillipines		23	38	109	47	51	45
Singapore	23	41	39	59	58	170	308
Thailand		19	61	102	77	77	124
South Asia	82	82	82	83	132	123	368
Bangladesh			6	15	24	19	31
Pakistan	39	13	17	17	31	25	221
Sri Lanka	42	65	57	47	61	55	50
Middle East	26	156	158	198	156	191	303
Iraq	6	71	50	20	30	44	60
Kuwait		3	10	40	23	27	89
Saudi Arabia						1	10
Syria	16	23	37	55	33	30	26
United Arab Emirates							
North Africa	33	99	56	74	109	78	150
Egypt	18	52	51	34	65	31	75
Libya			1	1	2	3	4
Sub-Sahara Africa	82	115	96	172	173	235	331
Nigeria	1	8	1	12	7	11	15
Sudan	18	37	24	56	40	92	127
Tanzania	8	15	14	21	13		
Zambia	48	20	27	29	25	44	64
Latin America	4	196	108	388	559	765	799
Argentina	2	21	3	87	62	193	189
Brazil	1	83	9	163	129	118	106
Chile		12	32	19	30	97	112
Mexico		25	10	33	124	114	93
Peru		46	42	36	36	52	72
Communist countries	389	1,005	1,078	1,067	1,537	1,841	1,934
U.S.S.R.	25	129	238	162	242	268	294
Eastern Europe	225	594	608	649	968	1,210	1,244
Czechoslovakia	31	70	70	73	126	117	162
East Germany	42	117	104	115	182	190	264
Hungary	8	41	40	32	58	68	55
Poland	26	60	63	61	98	148	109
Romania	72	220	249	239	374	580	515
Yugoslavia	4	12	11	48	35	41	104
Other	139	282	231	256	327	363	397

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[1] Data are reconstructed from various issues of Central Intelligence Agency, National Foreign Assessment Center, "China: International Trade". Data are rounded to the nearest $1,000,000. Components may not add to total because of rounding. Only major trade partners are shown within any trade figure. Area totals are based on reporting by 159 trade partners.

TABLE A-4.—CHINA: COMMODITY COMPOSITION OF EXPORTS, F.O.B., BY SECTOR OF ORIGIN [1]

[In millions of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
Total	2,155	7,130	7,270	8,090	10,085	13,720	19,590
Agriculture	1,005	2,835	2,680	2,705	3,205	3,865	NA
Of which:							
Live animals	65	215	230	245	255	250	315
Meat and fish	155	415	430	375	525	635	NA
Grain	115	720	450	395	350	335	NA
Fruit and vegetables	175	360	385	500	580	720	NA
Tea and spices	NA	100	140	180	230	315	NA
Oilseeds	65	140	85	85	95	200	NA
Natural textile fibers	105	250	285	290	400	510	NA
Crude animal materials	120	230	260	335	375	445	NA
Extractive	115	1,095	830	1,015	1,325	2,055	NA
Of which:							
Crude minerals	NA	120	65	85	140	185	NA
Coal	NA	130	95	80	100	175	NA
Crude oil	0	760	665	795	1,015	1,575	2,780
Manufacturing	1,035	3,200	3,765	4,370	5,555	7,795	NA
Of which:							
Petroleum products	0	150	175	225	235	605	1,030
Chemicals	110	300	330	410	475	800	NA
Textile yarn and fabrics	350	1,065	1,235	1,235	1,685	2,225	NA
Nonmetallic mineral products	NA	140	150	190	255	305	NA
Iron and steel	40	85	105	95	165	210	NA
Nonferrous metals	25	120	90	75	125	140	NA
Machinery	60	210	215	245	275	360	620
Transport equipment	30	130	70	45	50	70	100
Clothing	160	345	420	600	730	1,115	NA
Handicrafts	NA	190	320	365	425	575	NA

[1] Data are reconstructed from various issues of Central Intelligence Agency, National Foreign Assessment Center, "China: International Trade" (Quarterly Reviews and annual handbooks). Data are rounded to the nearest $5,000,000. For 1980 data are estimated from very preliminary trade partner statistics, and from occasional Chinese press releases.

TABLE A-5.—CHINA: COMMODITY COMPOSITION OF IMPORTS, F.O.B., BY END USE [1]

[In millions of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
Total	2,045	6,825	5,565	6,590	10,320	14,285	19,350
Foodstuffs	360	830	525	1,125	1,365	1,885	2,800
Of which:							
Grain	255	525	300	655	965	1,430	2,235
Sugar	75	165	185	300	265	200	NA
Oilseeds	5	15	5	115	35	115	NA
Consumer durables	15	30	30	40	110	310	500
Of which:							
Watches	5	15	15	45	75	125	NA
TVs, Radios				5	5	130	250
Industrial supplies	1,330	3,925	3,305	4,200	6,845	8,395	11,200
Of which:							
Natural textile fibers	85	240	175	420	695	995	2,000
Synthetic textile fibers	15	90	105	160	175	155	500
Synthetic textile fabrics	40	80	115	165	210	310	NA

TABLE A-5.—CHINA: COMMODITY COMPOSITION OF IMPORTS, F.O.B., BY END USE [1]—Continued

[In millions of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
Paper and paperboard	15	75	40	60	95	160	NA
Rubber	75	145	145	205	190	310	430
Petroleum and products	NA	95	40	40	55	40	NA
Fertilizer, manufactured	130	375	215	320	430	615	1,030
Plastic materials	25	65	85	90	130	150	NA
Metalliferous ores	NA	115	115	110	160	140	NA
Iron and steel	370	1,430	1,340	1,445	2,870	3,310	2,700
Nonferrous metals	190	415	240	250	410	490	NA
Metal products	NA	115	85	55	115	175	NA
Capital goods	340	2,040	1,705	1,225	2,000	3,695	4,850
Of which:							
Machinery	180	1,165	1,205	500	955	2,300	NA
Transport equipment	145	820	435	640	945	1,245	NA
Precision instruments	15	55	55	75	85	150	NA

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[1] Data are reconstructed from various issues of Central Intelligence Agency, National Foreign Assessment Center, "China: International Trade" (Quarterly Reviews and annual handbooks). Data are rounded to the nearest $5,000,000. For 1980 data are estimated from very preliminary trade partner statistics and from occasional Chinese press releases.

TABLE A-6.—CHINA: PRICE AND VOLUME INDEXES FOR INTERNATIONAL TRADE [1]

[Calculated in terms of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
Prices:							
Exports	100	204.3	185.0	212.1	212.9	239.6	276.7
Of which:							
Agricultural	100	185.8	175.4	199.5	206.3	213.9	....
Extractive	100	446.1	429.9	486.9	502.0	618.8	....
Manufacturing	100	185.3	170.4	209.6	205.0	233.9	....
Imports	100	190.7	163.1	146.3	151.3	173.8	203.2
Of which:							
Foodstuffs	100	301.4	269.6	123.7	146.5	154.1	....
Consumer durables	100	204.4	155.0	159.6	177.2	190.6	....
Industrial supplies	100	174.0	145.1	129.6	129.0	158.4	....
Capital goods	100	201.8	190.0	197.9	214.1	225.7	....
Volume:							
Exports	100	161.9	182.4	177.0	219.8	265.7	328.5
Of which:							
Agricultural	100	151.8	152.0	134.9	154.6	179.8	....
Extractive	100	213.4	167.9	181.3	229.5	288.8	....
Manufacturing	100	166.9	213.5	201.4	261.8	322.0	....
Imports	100	175.0	166.8	220.3	333.5	401.9	465.7
Of which:							
Foodstuffs	100	76.5	54.1	252.6	258.8	339.8	....
Consumer durables	100	97.8	129.0	167.1	413.8	1,084.3	....
Industrial supplies	100	169.6	171.3	243.7	399.0	398.5	....
Capital goods	100	297.3	263.9	182.1	274.7	481.5	....

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[1] Data for 1970–76 are reconstructed from CIA, National Foreign Assessment Center (NFAC), "China: Real Trends in Trade with Non-Communist Countries Since 1970," October 1977, and from CIA, NFAC, "China: International Trade, 1976–1977, November 1977. The price indexes are of the Paasche variety, using 1970 as a fixed base year. Although the price indexes were developed specifically for application to China's Non-Communist trade, the indexes have been used in this table to derive volume indexes for China's total trade. The volume indexes use the Laseyres formula. Data for 1977–1979 are derived from CIA, NFAC, "China: International Trade, Second Quarter 1980". The price indexes use the Paasche formula with a moving base year, and have been chain-linked with data for the earlier years. Data for 1980 are derived from statements in the Chinese press, and may not be consistent with the methods used in the CIA publications.

APPENDIX B.—CHINA'S INTERNATIONAL FINANCES

Estimating China's Balance of Payments continues to be a task fraught with problems. Although Beijing has shown increasing candor in providing overall economic statistics, it has been unwilling or unable to provide many of those related to balance of payments. China's statistical apparatus, disbanded during the Cultural Revolution, remains in disarray.[1] Until recently, Beijing itself probably did not possess a meaningful balance of payments table in the Western sense. Our approach to this problem has been to use Chinese pronouncements concerning various balance of payments items wherever possible and to make our own item-by-item estimates where Chinese data were not available.

Estimating China's current account—total trade in both goods and services—has become somewhat less difficult in recent years. Computerized trade statistics for most of China's trading partners has alleviated much of the work in estimating two-way merchandise trade.[2] Where sporadic Chinese pronouncements make comparison possible the estimates from foreign partner statistics have generally agreed with Beijing's. Figures for the service account stem largely from our own estimates, although Beijing has periodically provided information on tourist earnings and at least once on the overall level of earnings from services.[3]

Prior to 1980, estimates for the capital account were made by simply following whole-plant contracts and grain agreements that were signed on credit terms. As China's activity as both borrower and lender in the international financial markets has picked up, these flows have become increasingly difficult to track. As a result, much of the large errors and omissions figure for 1980 may be attributable to our inability to estimate accurately China's capital account.

Other possible sources of error in the 1980 estimate stem from large Chinese purchases of both new and used ships which may have necessitated foreign exchange outlays of perhaps as much as $1 billion last year alone. Much of this trade may not have appeared in partner country statistics because of problems associated with flags of convenience. China has also become more active than ever in the Hong Kong market where both foreign exchange outlays and receipts are difficult to estimate. Technology purchases, where Beijing pays for managerial expertise, patent rights, or know-how, are also difficult to track since services are not observable in trade statistics.

We continue to use Western banks' liabilities to China as reported by the Bank for International Settlements (BIS), as a proxy for China's foreign exchange reserves. The BIS figures differ slightly from those recently released by the Bank of China.[4] The Chinese reported reserves of $2.154 billion in 1979 and $2.262 billion in 1980; BIS figures for comparable periods show $2.661 billion and $2.527 billion. Because Beijing provided no explanation of their figures and since they have established no reliable reporting record to aid in future analysis, we continue to rely on BIS statistics. The less than total coverage of BIS data, however, and the fact that the figures rely on voluntary reporting by the banks involved, introduces other sources of balance of payments errors.

A. A GOOD SHOWING--1978-79

In 1978, Beijing's overall balance of payments position remained healthy despite a sharp upturn in imports. A strong performance in the service sector more than offset the $200 million trade deficit. Even with net capital outflows or more than a billion dollars, China's foreign exchange reserves by yearend probably amounted to about $2.4 billion, up slightly from the year-earlier level

Despite the bright showing for the year, Beijing was experiencing cash flow problems by February 1979. Imports exceeded exports by $400 million in the fourth quarter of 1978 and by almost twice that amount in the first quarter of 1979. Beijing was also making sizeable outlays in repayment for whole plant credits received in the mid-1970s. The cash flow problem probably contributed to China's February 1979 decision to refuse final approval to $2.6 billion in contracts it had initialed with Japanese firms. The contracts, approved only 2 months earlier by China's

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[1] For an insightful look into the problems China currently faces with its statistical apparatus see Sun Yefang's article "Consolidate Statistical Work, Reform the Statistics System", FBIS, Daily Report, China, 26 March 1981, p. L4.

[2] For a detailed discussion of the methodology used see: Central Intelligence Agency, National Foreign Assessment Center, China: International Trade Quarterly Review, First Quarter, 1979, ERCIT 79-001, September 1979.

[3] China's Foreign Trade, No. 3, May-June 1980, p. 3.

[4] See FBIS Daily, China, 7 July 1981 p. K2.

Technical Import Export Corporation, were suspended in part to avoid additional foreign exchange drawdown of nearly $300 million required to meet downpayment schedules. The reinstatement of all but one of the contracts only 3 months later, almost all on a cash basis, is strong evidence that Beijing did not view itself as having any long-term balance of payments problems.

By yearend 1979 Beijing had corrected its cash flow difficulties. The $1.1 billion trade deficit registered in the first half was reduced to $600 million by yearend. Net earnings from invisibles left Beijing with a current account surplus of about $200 million. Although net borrowings, mostly commercial, were up sharply to $800 million, China's total debt outstanding probably remained below $2.5 billion. borrowings were especially small when considered in light of the $30 billion in credit lines available to China at that time. Foreign exchange reserves by December probably amounted to about $2.7 billion (equivalent to about 10 weeks of 1979 imports), up $200 million from 1978.

B. The Problems of 1980

With exports growing at a phenomenal 40 percent clip, China probably registered a slight trade surplus in 1980, the first since 1977. In view of increased earnings from tourism, shipping, and private overseas remittances, the current account surplus for the year may have surpassed a billion dollars. Although the net value of capital flows is difficult to estimate for 1980, foreign exchange reserves fell by $150 million from the record 1979 level to $2.5 billion. As of September 1980, Chinese officials were predicting that total debt outstanding by yearend would be at the $3.4 billion mark with repayments for principle and interest during the year of only $2.5 billion.

Despite its apparent strong showing in the 1980 current account, Beijing was complaining of balance of payments problems by November of that year. The yearend financial crunch, as was the case in early 1979, probably reflected cash flow difficulties rather than underlying balance of payments problems. The annual 1980 trade surplus, for example, belies the fact that during the fourth quarter imports exceeded exports by more than $300 million. In addition the Bank of China, (BOC) China's foreign exchange bank, may not have had access to the entire pool of export earnings. Reports circulating that Beijing was about to rescind its decentralization measures, may have sparked provincial-and-municipal level entities into stepping up the transfer of their foreign exchange holdings abroad. The outflows may have drained up $500 million in expected foreign exchange earnings out of reach of the Bank of China in the fourth quarter alone.

Despite a solid performance for the year, the Bank of China probably found itself somewhat short of foreign exchange in the fourth quarter. Faced with a minor financial crunch the bank may have overreacted. There are indications that BOC made large overdrafts in late 1980 and early 1981 and may have suffered penalities for early drawdowns of certain of its deposits abroad.[5] BOC's inexperience in the world of international finance into which it has been drawn over the past few years may be largely responsible for its erratic conduct. Bureaucratic problems associated with centrally planned economies may also have prevented effective response to unexpected problems. In addition, Beijing had little reason to hide its liquidity problems at a time when it was actively involved in lining-up long-term, low interest loans from international financial institutions. Since last December, Beijing has borrowed more than $1 billion from the IMF, mostly for balance of payments support, and has reportedly received a conditional commitment from the World Bank for an additional $200.

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[5] Most of the speculation linking China's February 81 unilateral cancellation of $2 billion in Japanese and Western whole-plant equipment with balance of payments problems appears to be unjustified. Even after announcing the cancellations Beijing continued to pay cash for delivery of the cancelled equipment. By mid-1981 most of the material has either already been delivered or China has agreed to accept delivery under the original terms. The exceptions are contracts for construction of the second phase of the Baoshan steel mill which remains suspended.

TABLE B-1.—CHINA: BALANCE OF PAYMENTS [1]

[In billions of U.S. dollars]

	1978	1979	1980
Current account	0.9	0.2	1.2
Merchandise trade	−.2	−.6	.2
Exports (fob)	10.2	13.8	19.6
Imports (fob)	−10.4	−14.4	19.4
Services and transfers	1.1	.8	1.0
Tourism	.3	.4	.6
Freight	.2	.2	.4
Unrequited transfers	.3	.5	.4
Technology	([3])	−.3	−.3
Interest	.1	−.1	([3])
Earnings from Hong Kong	.1	.2	.2
Other invisibles	.1	−.1	−.3
Capital account	−1.1	.3	.8
Medium and long term	−.9	−.6	.4
Whole plant	−.1	−.2	.2
Government credits	−.8	−.5	−.2
International organizations	0	0	.3
Foreign investment	0	([3])	.1
Grain	([3])	.1	.1
Short term	−.3	.9	.4
Down-payments for whole plants	−.4	−.2	.3
Commercial	.4	1.2	.1
Settlement accounts	−.4	−.2	−.1
Changes in reserves [2]	−.1	−.2	.1
Errors and omissions	.3	−.2	−2.1

[1] Tables may not add due to rounding.

[2] Negative sign indicates an increase in foreign exchange reserves.

[3] Negligible.

CHINA'S CAPITAL CONSTRUCTION: CURRENT RETRENCHMENT AND PROSPECTS FOR FOREIGN PARTICIPATION

By Nai-Ruenn Chen*

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I. INTRODUCTION

China's current economic readjustment centers on the retrenchment of capital construction. Total investment in capital construction, for example, is to be decreased from 53.9 billion yuan in 1980 to 30 billion yuan in 1981, a reduction of 44.3 percent. This is in sharp contrast to the ambitious 10-year economic program (1976–85) unveiled in March 1978, which called for a total investment in capital construction during the 8-year period (1978–85) equal to that of the previous 28 years, or some 600 billion yuan.

One major feature of the capital construction program announced in 1978 was the large role given to foreign plants and technology for the construction of 120 major projects. Long-term trade agreements were reached with Japan, France and Great Britain for the import of modern plants, equipment and technical know-how, and, to finance these imports, large lines of credit were arranged with foreign banks. During 1978 a series of contracts valued at $7.8 billion for the supply of equipment and technology for 22 major projects were signed with foreign companies. These activities created great interest in the Western business community in what was perceived as a vast new market. This period is now characterized in Chinese press articles as "yangyuejin," or a leap outward toward foreign countries for the supply of capital and technology, in contrast to the earlier "dayuejin," or Great Leap Forward that relied largely on indigenous, labor-intensive methods.

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*International Trade Administration, U.S. Department of Commerce. This paper was completed last summer on the basis of information as of July 1, 1981. Additional source materials that have become available since that time are generally consistent with the trends in and policies toward China's capital construction and foreign trade, as they were described or predicted in this paper.

The period of "yangyuejin," however, was relatively short. After a sober assessment of the country's economic situation, Chinese planners came to the realization that there were serious problems in the capital construction sector caused by poor planning, inefficient management, and excessive investment, and that these problems were exacerbated by a further upsurge of investment activity during 1978. As a result, steps were taken in early 1979 to scale down the capital construction program, and many of the 120 major projects were cancelled or postponed. Negotiations with foreign firms slowed down considerably.

At that time, however, the scope of China's economic difficulties had yet to be fully appreciated, and the central government's instructions to cut back investment spending were not strictly adhered to at all levels. The result was a continued rise in total capital construction expenditures in both 1979 and 1980. In the meantime, new economic problems surfaced. A decision was made in late 1980 to "further readjust" the economy primarily by reducing substantially further the scale of capital construction. This led to the cancellation of a number of contracts with foreign countries, especially Japan.

The retrenchment has caused considerable concern among Western businessmen who are, or are interested in, dealing with China. This concern focuses on the problems which have plagued China's capital construction sector, the measures adopted by the Chinese government to resolve them, their impact on China's foreign trade and investment, and future prospects for foreign business in China.

The main purpose of the paper is to analyze these issues with special reference to China's own perceptions of its problems and policies relating to capital construction and foreign trade. To put these problems and policies in proper perspective, past policies also are examined briefly. While analysis is based primarily on published Chinese sources, personal discussion with Chinese officials and economists especially at the week-long World Economy Symposium in Hangzhou and during visits to several Chinese cities in March and April 1981 provided additional insights into China's current economic problems and policy directions.

II. CAPITAL CONSTRUCTION

The current retrenchment is based on the consideration that the capital construction sector had expanded too rapidly, causing its scale to exceed by far China's resources and capabilities. Before discussing the retrenchment program, attempts are made to examine past investment trends and the causes and consequences of the rapid expansion of capital contruction.

Investment Trends

In the first three decades of the People's Republic, China generally followed a policy geared toward rapid capital formation. This may be seen from Chinese estimates of the "rate of accumulation", i.e., the ratio of accumulation to national income.[1] The rate averaged 15.8 percent during the rehabilitation period (1950-52), and rose to 24.2 percent during the First Five-Year Plan (FYP) (1953-57), a period in which great efforts were made to mobilize all available resources for the industrialization drive. The rate increased further to 30.8 percent during the Second FYP (1958-62), the first three years of which saw the Great Leap Forward movement—the rate was 33.9 percent in 1958, 43.8 percent in 1959, and 39.6 percent in 1960. The post-Leap economic crisis brought the rate down to 19.2 percent in 1961 and 10.4 percent in 1962.

The rate of accumulation recovered to 22.7 percent during the readjustment period (1963-65), and grew to 26.3 percent during the Third FYP (1966-70) in spite of the economic disruptions caused by the Cultural Revolution. The rate went up to 33 percent during the Fourth FYP (1971-75), and continued to rise afterwards reaching 36.6 percent in 1978, the highest since the Great Leap Forward.[2]

During the period 1953 to 1978 as a whole, the average rate of accumulation was 30 percent.[3] For the recent period 1970-78, the average was higher—33 percent.[4] This pace of capital formation appeared to be far more rapid than that in the West. Even compared to other communist countries which as a rule tend to have high rates of accumulation, an average of 30 percent over a considerable period of time should be considered unusually high.[5]

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[1] According to Chinese usage, national income may be defined in terms of production and final expenditure. From the standpoint of production, the national income (guomin shouru or guomin shouru shengchan) denotes the net value of output of material-producing departments including industry, agriculture, construction, communications and transport, and commerce during a given year. From the standpoint of final disposal, the national income should be adjusted in accordance with the difference between the value of goods purchased from abroad and the value of domestically produced goods exported during the same year. This is known as national income expended (guomin shouru shiyong), which is then divided into "accumulation" and "consumption". Accumulation is that part of national income used to increase fixed capital assets, working capital, and material reserves.

[2] Data on the rates of accumulation are given in Yang Jianbai, "Some Views on the Problem of the Accumulation Rate", Renmin Ribao, February 9, 1981, p. 5; Yang Jianbai and Li Xuezeng, "The Relations Between Agriculture, Light Industry and Heavy Industry in China, "Social Sciences in China, No. 2, June 1980, pp. 182-212; and Liao Jili and Gao Yisheng, "Readjust Our Country's Heavy Industrial Production Structure into Light Industrial Production Structure," Hongqi, No. 16, August 16, 1980, pp. 22-27.

[3] Zhao Renhai, "Explore A Rational Rate of Accumulation", Nanfang Ribao, July 12, 1980, p. 3.

[4] Renmin Ribao, June 9, 1980, p. 1.

[5] The rate of accumulation in the Soviet Union was in the neighborhood of 25 percent during the Stalin era. After 1950, the Soviet rate tended to rise gradually: 23.9 percent in 1950, 25.7 percent in 1955, 26.8 percent in 1960, 26.4 percent in 1965, and 29.5 percent in 1970. The rate rose to nearly 30 percent in the early 1970s, but fell to around 26 percent in recent years. The accumulation rates in East European countries generally also remained below 30 percent. East Germany had relatively low rates—rising from 18.1 percent in 1960 to about 22 percent in the years after 1966. Poland's accumulation rates were relatively high—for example, 24.2 percent in 1960, 27.9 percent in 1970, and 37.2 percent in 1975. The Hungarian rate was 21.2 percent in the Second FYP (1961-65), 23.5 percent in the Third FYP (1966-70), and 27.7 percent in the Fourth FYP (1971-75), and exceeded 30 percent in 1978. The rate in Czechoslovakia was 17.7 percent in 1960, 27 percent in 1970, and 29.3 percent in 1975. (See Pei Yuanxiu, Liu Bingying and Li Bingzhong, "An Inquiry into the Optimum Accumulation Rate", Guangming Ribao, June 28, 1980.)

High rates of accumulation usually reflected large investment in capital construction.[6] This type of investment constituted 38 percent of accumulation in 1952 and about 50 percent in 1953, and reached some 70 percent throughout the second half of the 1950s. Total investment in capital construction was 4.36 billion yuan in 1952, 8 billion yuan in 1953, and reached 13.8 billion yuan in 1957. The Great Leap Forward pushed total investment in 1958 upward by 93 percent to a level of 26.7 billion yuan.[7] By 1960 capital construction investment had reached 38.7 billion yuan, 2.8 times the 1957 level.[8]

The post-Leap economic retrenchment caused capital construction investment to decline not only in absolute size but perhaps in its share of accumulation as well.[9] The share may have remained no more than 50 percent since then.[10] Nonetheless, the size of capital construction investment continued to expand after the late 1960s as both national income and the rate of accumulation increased. Total investment in capital construction was 32.145 billion yuan in 1971 and 36.5 billion yuan in 1977, It rose 31.2 percent in 1978 reaching a record of 47.9 billion yuan.[11]

Causes for Overexpansion

Rapid expansion of China's capital construction is attributable to a number of reasons. One is the Chinese system of planning and management. Under China's command economic structure, production targets were usually set at high levels and the performance of an enterprise was judged primarily on the basis of the extent to which the output targets were met. Attempting to fulfill and overfulfill such targets, Chinese enterprises tended to overextend investment in capital construction. This tendency was reinforced by the Chinese system of granting investment funds from the state budget to individual enterprises. Inasmuch as such funds were not to be repaid and were interest-free, many enterprises tended to vie with one another for more appropriations to build more projects, thus leading to an overexpansion of capital construction.

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[6] In China, "capital construction" (jiben jianshe) refers to the investment which will result in additions to the productive and nonproductive fixed assets. Included in capital construction investment are not only expenditures on construction and installation and on purchases of machinery and equipment but also all such expenditures ancillary to the process of fixed capital formation as geological surveys and exploration, engineering design, scientific testing and research, workers' training, and compensation for moving expenses paid to the original residents on construction sites. For a further discussion of China's capital construction investment and related statistical data, see Nai-Ruenn Chen, Chinese Economic Statistics, Chicago: Adline Publishing Company, 1967.

[7] Nai-Ruenn Chen, p. 158. Figures on "total investment in capital construction" used throughout this paper, unless otherwise specified, refer to investment of state enterprises.

[8] Xue Muqiao, "China's Economic Development and Its Prospects", a paper presented at the Seminar on New Development Trends in China's Economy, Hong Kong, October 8, 1980.

[9] Capital construction investment was reduced by one-third in 1961 from the previous year's level, and was curtailed further by one-half in 1962. See He Zhenyi and Chen Lingshu, "An Initial Study of the Role of Finance in Correctly Handling the Proportional Relations Between Accumulation and Consumption", Jingji Yangjiu, no. 11, November 20, 1980, pp. 49–53.

[10] In 1979, for example, the amount of accumulation was 112 billion yuan and capital construction investment, 50 billion yuan. It should be noted that these two figures are not strictly comparable because the former was estimated in 1970 prices and the latter in "current budgetary prices".

[11] The 1971 figure is taken from Yang Jianbai and Li Xuezeng, p. 192. The figures for 1977 and 1978 are based on the annual communiques on the Chinese economy issued by the State Statistical Bureau.

Another reason for such overexpansion had to do with the fact that many localities in China attempted to pursue self-reliance and self-sufficiency. A long-held economic goal of the Chinese Communist Party has been the creation of an "independent and relatively comprehensive economic and industrial system" capable of producing a wide range of products. This goal may be desirable for the country as a whole. But when individual provinces and localities also attempted to become economically "independent and relatively comprehensive", the results were a proliferation of construction projects and inefficient utilization of existing resources. Examples abound. Steel plants were built in many a locality where no significant reserves of iron ore existed; coal mines were constructed in areas with no appreciable coal deposits; sugar refineries could be found in places not known to produce sugar crops.[12] The proliferation of construction projects was reflected in rapid increases in the number of industrial enterprises. This number rose from 154,000 in 1965 to 294,000 in 1976, and reached 348,000 in 1978.[13]

The third, and most important, reason for the rapid growth of China's capital construction investment was the bias in its development strategy toward capital-intensive technology. This strategy was designed to maximize the rate of economic growth, and was largely oriented toward heavy industry. Light industry and agriculture were assigned roles supportive of industrialization.

This mode of development was reflected in the sectoral distribution of Chinese investment. During the First FYP, the share of heavy industry in the country's capital construction investment was 46.5 percent, compared to 5.9 percent for light industry and 7.8 percent for agriculture.[14] The bulk of investment in heavy industry was used for 156 Russian-designed projects, including 7 iron and steel plants, 24 electric power stations, and 63 machinery plants. Many of them involved the movement to China of equipment for entire factories.

The undesirable consequences of the lopsided development of heavy industry had been recognized by Chinese leaders by the latter half of the First FYP. Mao Zedong discussed the problems created by overemphasis on heavy industry and the need to develop light industry and agriculture in his famous speech "On the Ten Major Relationships" in 1956.[15] Instead of pursuing a balanced growth approach, however, emphasis on heavy industry was increased further after the First FYP. For the period 1952–78 as a whole, heavy industry took up as much as 54.2 percent of total investment in capital construction.[16] The average annual investment in heavy industry during 1971–78 was about four times the figure for the First FYP.[17]

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[12] Lin Senmu, Tan Kewen, and Zhou Shulian, "On Raising the Effectiveness of Investment", Jingji Yanjiu, no. 6, June 20, 1980, pp. 26–32.

[13] Xu Gang, "To Stand on Firm Ground and Advance Continuously with Readjustment", Renmin Ribao, January 15, 1981, p. 5.

[14] Nai—Ruenn Chen, p. 159.

[15] Mao Zegong's Selected Work, Vol. V, Beijing, 1977, pp. 267–288.

[16] During the same period, light industry accounted for only 5.4 percent of total investment in capital construction and agriculture, 12 percent.

[17] See Pei Yuanxiu, Liu Bingying, and Li Bingzhong, p. 4. The average annual capital construction investment in heavy industry was 5,120 million yuan during the First FYP, and rose to 13,325 million yuan during the Second FYP. In the readjustment period (1963–65), it still

Continued

The rapid raise of investment in heavy industry was in large measure attributable to the Chinese policy of "taking steel as a key link", which regarded the development of the steel industry as the prerequisite to industrialization. Steel output targets were frequently set at untenably high levels.[18] This called for substantial growth of investment in the steel industry.[19]

To support the expansion of the steel industry also required increases of investment in certain other branches of heavy industry. Timber, cement, steel, and machinery and equipment are needed for constructing a steel plant. To operate a plant requires supplies of iron ore, coal and electric power as well as adequate transport facilities. High steel targets, therefore, forced up targets for other related branches of heavy industry causing their investment requirements to rise as well. Thus, rapid expansion of China's capital construction was, to a significant degree, occasioned directly or indirectly by emphasis on steel production.

Consequences of Overexpansion

Capital construction requires skilled labor, machinery and a wide range of materials, most of which are also needed by the existing factories and farms to carry out their production.[20] In China, these resources are scarce. The rapid expansion of capital construction, therefore, not only cut into the supply of resources necessary to meet current production needs thereby leading to excess capacity and lower output levels, but also resulted in protracted periods of construction and higher costs for new and ongoing projects.

The shortfalls were particularly severe for certain building materials such as rolled steel, lumber and cement; 20 percent of the demand for these materials by the capital construction sector was not met in the 1970s.[21] The problems appeared to have become more serious in recent years.[22] As a result, the amount of time needed to complete a construction project became increasingly larger. The average construction period of large and medium-sized projects reached eleven and half years during the 1970s, compared to six years during the First FYP.[23] In 1980, the average reached

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reached 6,709 million yuan, exceeding the average for the First FYP. During the Third FYP which included the most tumultuous years of the Cultural Revolution, the figure was 10,495 million yuan. The average rose sharply to 18,412 million yuan during the Fourth FYP (1971–75) and to 21,928 million yuan during 1976–78. For a useful discussion, see Yang Jianbai and Li Xuezeng, especially pp. 189–194.

[18] This was especially so for 1958–59. Steel output was set at 10.7 million tons in 1958, twice the previous year's level, and the target hit 18 million tons in 1959. The 1985 target of 60 million tons, originally set in the 10-year program (1976–85) unveiled in 1978, was later considered unrealistic.

[19] The share of the metallurgical industry in total capital construction investment rose from 10.14 percent in 1957 to 17.68 percent in 1958 and 16.13 percent in 1959. Economic readjustment caused investment in steel to slow down in the early 1960s, but high steel output targets again pushed the share upward to an average of about 13 percent in the early 1970s. (Yang Jianbai and Li Xuezeng, pp. 190–192).

[20] In the past 10 years, the share of capital construction in the national consumption of building materials was 20 to 25 percent for rolled steel, 25 to 33 percent for lumber, and 33 to 50 percent for cement. See Peng Hao, "The Scale of Capital Construction and Comprehensive Balance", Renmin Ribao, January 20, 1981, p. 5.

[21] Lin Senmu, Tan Kewen, and Zhou Shulian, p. 28.

[22] In 1980, for example, the shortfalls were 15 percent for rolled steel, 30 to 40 percent for lumber, and 40 percent for cement. (Xu Yi, Chen Baosen, and Tao Zengji, "The Key Is to Readjust the Scale and Structure of Capital Construction", Renmin Ribao, November 28, 1980, p. 5).

[23] Lin Senmu, Tan Kewen and Zhou Shulian, p. 26; Lin Senmu and Zhou Shulian, "Act According to the Capital Construction Procedure", Renmin Ribao, March 17, 1980, p. 5; and Editorial of Renmin Ribao, June 16, 1980, p. 1.

16 years.[24] Among the more than 1,000 such projects currently under construction, more than 300 of them have taken 10 to 15 years, nearly 50 projects 15 to 20 years, and more than 100 projects over 20 years.[25]

Long delays in construction allowed fewer than half of the projects that were scheduled to begin operations between 1974 and 1978 to actually start.[26] This delay not only slowed down production, but also added to costs. According to an official estimate, the wage cost and administrative expenses alone would have to rise by more than 5 billion yuan if all of the projects under construction were to be delayed by one year.[27] Shortages in building materials forced their prices up, also adding to the cost of construction.[28] Inefficient planning and management contributed further to higher costs of construction.[29] Of the 118 large- and medium-sized projects completed in 1979, 52 exceeded original cost estimates—some of them by more than 10 percent.[30]

Both protracted periods and higher costs of capital construction led to huge amounts of investment funds—several tens of billions of yuan—to be tied up in ongoing projects.[31] In 1978, the amount of funds so tied up in China was 150 percent of the new investment during the year, in constrast to 85 percent for the Soviet Union and 40 percent for the United States.[32]

In early 1979 when Chinese planners reviewed the development of capital construction, they began to realize the serious magnitude of the problems in that sector. The total number of construction projects undertaken by state enterprises came to several tens of thousands, including more than 1,000 medium and large ones.[33] Because too many projects were undertaken at the same time, there existed severe constraints on the supply of capital funds, equipment, construction materials and skilled labor. To complete all of the ongoing projects, for example, would require more than 100 billion yuan, or 6 to 7 times the annual investment currently earmarked in the state budget.[34] If all projects were carried to completion, no new projects could be introduced in the next several years without substantial increases in the investment budget.

Moreover, many of the 1,000 plus medium and large projects under construction did not have guaranteed sources of fuel, power, and raw materials, were incomplete in design, or lacked adequate technology. Shortages in fuel, power and raw materials frequently forced a newly completed project to remain idle or operate considerably below capacity.[35] According to a survey for Liaoning Province, of the 74 medium and large projects completed during 1974 to the first half of 1979, 18 operated below capacity and 17 did not operate at all.[36]

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[24] Liu Lixin and Tien Chunsheng, "How to Understand the Retrenchment of the Capital Construction Scale", Hongqi, no. 8, April 16, 1981, pp. 9-13.

[25] Lin Senmu, Tan Kewen and Zhou Shulian, p. 26; and Lin Senmu and Zhou Shulian, p. 5.

[26] Renmin Ribao, March 24, 1979, p. 1.

[27] Liu Lixin and Tien Chunsheng, p. 10.

[28] Ibid, p. 11.

[29] From the First FYP to the Fourth FYP, average investment rose from 1,342 yuan to 2,452 yuan for producing one ton of steel, 56 yuan to 119 yuan for mining one ton of coal, and 570,000 yuan to 1,930,000 yuan for constructing a kilometer of railways. (Yang Jianbai, p. 5). These increases were attributable partly to factors associated with industrial development such as "capital deepening" resulting from the use of more advanced technology, and party to inefficient planning and management such as overcommitment of resources to construction. According to a People's Bank of Construction's survey of 45 civil construction projects covering 119,000 square meters of floor space, the average construction cost per square meters was 110 yuan in 1978, compared to 46 yuan for similar projects completed prior to 1966. Of the 64 yuan increase in cost, 44 percent was attributable to inefficient use of resources.

[30] Lin Senmu, Tan Kewan and Zhou Shulian, p. 28.

[31] Liu Lixin and Tien Chungsheng, p. 11.

[32] Sin Senmu, Tan Kewen and Zhou Shulian, p. 26.

[33] Renmin Ribao, March 24, 1979, p. 1.

[34] Liu Lixin and Tien Chunsheng, p. 10.

Policy Choice: Retrenchment

With these monumental problems on their hands, China's leaders were confronted with critical choices. One route was to continue the past policy of rapid capital formation by expanding the States investment budget to carry all ongoing projects to completion and to initiate new construction activities required for implementing current economic plans. This option was ruled out by the pragmatic leadership not only because by 1978 the rate of investment had already reached at a dangerously high level, but more importantly because there was an urgent need to allocate greater proportions of national income for the purpose of raising personal consumption levels.

Average income of the Chinese people may have declined significantly from the second half of the 1950s to the second half of the 1970s. For example, average industrial wage in 1976 was 6.8 percent lower than in 1964, and 3 percent lower than in 1957.[37] As a result, real per capita consumption declined over time,[38] affecting the morale of Chinese workers.

The post-Mao leadership apparently came to the realization that any further decline in the consumption standards could have disruptive effects not only on economic growth but, more importantly, on the social and political stability of the country. After having lived at a level not substantially higher than subsistence for three decades under a socialist system, many Chinese were thirsting for higher consumption standards.[39] The increased exposure of the Chinese populace to greater economic progress and higher living standards of other countries in recent years may have added to the confidence erosion. The Chinese leadership came to the conclusion that rising consumer expectations could not be ignored any longer, and that in the absence of sustained, high economic growth rates any significant increase in consumption could be achieved only at the expense of investment.

It was against this background that a decision was made in the spring of 1979 to retrench the capital construction sector. The state investment budget for that year was to be reduced by 20 percent. A program was mapped out to stop or postpone a number of projects,[40] and efforts were to be concentrated on the construction of certain priority projects.[41]

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[35] One well known example was the newly completed West German cold rolling mill and Japanese hot strip mill in Wuhan, both of which were operated at only about 25 percent of designed capacity in 1979 due to lack of electricity.

[36] Lin Senmu, Tan Kewen and Zhou Shulian, p. 28.

[37] Pei Yuanxiu, Liu Bingying, and Li Bingzhong, p. 4.

[38] In monetary terms, per capita consumption rose from 102 yuan in 1957 to 103 yuan in 1960, 125 yuan in 1965 and 161 yuan in 1976. In real terms, however, per capita consumption declined between 1957 and 1960, and between 1965 and 1976. See Lin Senmu and Zhou Shulian, "Reduce the Scale of Capital Construction, Try to Gain Initiative in Economic Work", Hongqi, no. 3, February 1, 1981, pp. 9–13.

[39] This was apparently one of the reasons which prompted Deng Xiaoping to put forward "Four Basic Principles" in March 1979. See Editorial Department, "Correctly Recognize the Situation and Policies, and Insist the Four Basic Principles", Hongqi, no. 5, March 1, 1981, pp. 2–11.

At the same time, a major reform of capital construction management was planned—to replace the system of direct budgetary grants with that of bank loans at interest for future construction projects. In August 1979, the State Council approved the "Trial Regulations for Capital Construction Loans", and the People's Bank of Construction was vested with the authority to handle loan applications. Experiments first were conducted in Shanghai, Jilin and Henan, and later were expanded to selected enterprises in 28 provinces, special municipalities, and autonomous regions.[42] The State Council decided in late 1980 that beginning in 1981 all enterprises and business undertakings which had their own independent accounts and possessed repayment capabilities should use bank loans for capital construction.[43]

Emergence of New Problems

Following the introduction of the retrenchment policy in early 1979, 295 medium- and large-sized projects were cancelled or suspended in that year and 283 more in 1980 leaving only 904 projects under construction. Capital construction investment funded by the State budget remained at the 1978 level of 39.5 billion yuan in 1979, and declined to 28.1 billion yuan in 1980. But total investment in capital construction continued to rise—from 47.9 billion in 1978 to 50 billion yuan in 1979 and 53.9 billion yuan in 1980. This was because capital construction investment outside the state budget increased sharply—from 8.4 billion yuan in 1978 to 10.5 billion yuan in 1979 and 25.8 billion yuan in 1980.[44]

Thus the scale of capital construction actually expanded in 1979 and 1980, although the number of medium and large projects under construction had been reduced by 39 percent. This was due partly to the large scale of certain new projects initiated in these years, and partly to a large increase in the number of locally-financed small projects. Local governments and enterprises were given greater authority to initiate new projects and allocate the funds made available to them by recent economic reforms. In practicing this newly acquired power, local authorities failed to follow closely the central government's guidelines with respect to investment in capital construction, thus creating new problems for the Chinese economy.[45]

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[40] The projects to be stopped or postponed included those with (1) uncertain resources and geological conditions; (2) incomplete design or substandard techniques; (3) inadequate supply of building materials, equipment, funds, and work force; (4) lack of guaranteed resources of fuel, power, raw materials, and water as well as the means of transportation; (5) obsolete technology and large raw material and fuel consumption; and (6) lack of solution to the problem of pollution. (Renmin Ribao, March 24, 1979, p. 1.)

[41] Included in these priority projects were (1) key projects using the latest equipment and technology; (2) coal mines, power stations, oilfields, transport and communication facilities, building material plants and other currently lagging sectors; (3) light industrial plants, textile mills, housing, public utilities, and those other projects bearing on the people's livelihood; and (4) export processing and tourism projects.

[42] The experiments covered over 20 sectors of the economy including electric power, textiles, light industry, coal, petroleum, transport, building materials, metallurgy, chemicals, commerce and tourism. All of the large- and medium-sized thermal power projects under the Ministry of Electric Power had been financed by bank loans. In certain special municipalities and provinces such as Shanghai, Hubei, Fujian and Yunnan, about one-third of the investent funds which were formerly granted by the state budget had come from bank loans. As of November 1980, all units experimenting with the new system had signed with the Bank of Construction more than 690 loan contracts valued at 3.35 billion yuan. See Renmin Ribao, November 18, 1979, p. 1; September 22, 1980, p. 5; and January 3, 1981, p. 1.

[43] Remin Ribao. November 27, 1980. p. 2.

[44] Data on capital construction investment are based on the annual communiques on the Chinese economy issued by the State Statistical Bureau.

A large number of plants were constructed in raw material producing areas with funds outside the state budget in response to a policy calling for exploitation of local comparative advantage. This led to a reduction in the supply of raw materials for the traditional production centers, causing many modern plants to operate below capacity. A case in point is cotton textile production. Currently the domestic supply of cotton is sufficient to meet only two-thirds of production needs owing to an upsurge in the number of small textile factories, many of which were constructed in 1980. In Henan Province alone there are now more than 100 such factories using 10,000 metric tons of high grade cotton a year.[46] Inasmuch as the plants in the traditional production centers are as a rule more advanced in technology and produce products of better quality at lower costs, competition from small plants in raw material producing areas will result in net economic losses for the country as a whole.

Since most of the locally-financed small projects built in recent years were in the manufacturing and processing sectors, their construction tended to aggravate imbalances in the Chinese economy. The past economic growth policies had created critical economic bottlenecks—for example, energy shortages, backward transport and other service sectors and inadequate supplies of building materials. One of the main goals of the current economic readjustment policy is to improve these lagging sectors by providing them with more investment funds. But local investment resources tended to stay away from these sectors, and were mostly concentrated on more profitable projects in the manufacturing and processing areas thereby increasing the already heavy pressures on the energy, transport and building material sectors.[47]

While Chinese planners were concerned over their inability to bring down overall investment in capital construction and the rise in the number of local projects, they were plagued by two other emerging problems which posed a potentially far greater threat to China's economic growth and stability. One of these problems came to light as the result of a reassessment of the country's oil output potential. In its original blueprint for modernization, oil was envisaged not only as an important source of energy needed for domestic development but also a major foreign exchange earner for financing import requirements. But the recent reassessment led the planners to conclude that their earlier estimates of China's oil potential had been too optimistic, and that oil exploration and development technology was grossly inadequate. The neglect of the coal and electric power industries in the allocation of resources in the past contributed to the energy problem.

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[45] Wang Jiye and Wu Kaitai, "Firmly Grasp Adjustment and Stabilize the Economy" Jingji Yanjiu, no. 1, Jan. 20, 1981, pp. 3–9.

[46] Peng Hao, p. 5.

[47] Xu Yi, Chen Baosen and Tao Zengji, p. 5.

Crude oil production has grown at a much slower pace in recent years, and actually declined in 1980. Output is expected to remain at current levels or even decline further in the next few years. This is in sharp contrast to the high rates of growth experienced nearly each year in the last two decades. China is having difficulties in meeting oil export commitments to Japan in exchange for Japanese equipment and technology, as required by the long-term trade agreement signed by the two countries in 1978. A large number of industrial projects under China's development plan were energy-intensive. The PRC had signed contracts to purchase foreign plants for many of these projects, and was in the process of negotiating others. If these projects go to production, China would have to become a significant net importer of oil. This could lead to huge trade deficits in the future, an unthinkable prospect to China's conservative financial administrators.

The other problem had to do with an incipient inflation in the economy. As noted above, when the post-Mao leadership faced a choice between a continued stagnation of living standards and lower investment rates, it opted for the latter for both economic and political reasons. Industrial wages were raised;[48] The bonus system was reinstituted; and experiments were carried out giving greater decisionmaking power to the enterprises. A number of important measures were taken to improve agricultural incentives, including increases in farm procurement prices.[49] But increases in consumption funds exceeded the targets and, at the same time, investment continued to rise. Thus for three years in a row consumption and investment exependitures outgrew national income.[50] This manifested itself in, among other forms, state financial deficits and shortages of consumer goods. To make up part of the deficits, the government had to rely on the issuance of currency, thus generating inflationary pressures on the economy.

Chinese leaders are fully aware of the deleterious effects of inflation. They have attributed their victory in 1949 partly to the failure of the Nationalists to resolve the problem of inflation. They have prided themselves on their ability to quickly bring inflation under control after they came to power and to maintain a general price stability throughout the first three decades of their rule. Recent price hikes have offset some of the increases in consumer income brought about by the current readjustment policy. Continuing inflation not only would wipe out consumer gains in recent years but could cause living standards to deteriorate to a level unacceptable to the masses.

Further Retrenchment

Considered a "latent danger" in the economy, these new problems had to be tackled immediately and resolutely, in the view of many Chinese policymakers especially Chen Yun, the top economic planner and an influential party leader. The basic solution was to reduce China's capital construction to a size consistent with the country's financial and resource capabilities.[51] Thus in late 1980 a decision was made to take bold steps to severely reduce investment expenditures, to cancel or suspend a large number of ongoing projects including those involving imports, and to bring capital construction projects under centralized control.

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[48] Average annual wage of staff and workers in state-owned units rose from 602 yuan in 1977 to 644 yuan in 1978, 705 yuan in 1979, and 762 yuan in 1980.

[49] State purchase prices for farm and sideline products were raised by 22.1 percent in 1979, and by another 7.1 percent in 1980.

[50] Wang Jiye and Wu Kaitai, "Adjustment and Comprehensive Balance", Hongqi, no. 4, February 16, 1981, pp. 2-6.

Total investment in capital construction in 1981 will be reduced from the originally planned 55 billion yuan to 30 billion yuan. Budget-funded investment will be cut from the original target of 24.2 billion yuan to 17 billion yuan.[52] Investment outside the state budget, therefore, is to be set at 13 billion yuan for 1981 compared to an actual level of 25.8 billion yuan in 1980.

During the first four months of 1981, more than 100 medium and large projects were stopped or suspended.[53] Selected for stoppage or suspension were those projects (1) where suitable conditions for construction did not exist; (2) where, if completed, production could not be carried out efficiently; and (3) where there would be competition with existing enterprises for raw materials, fuel and energy.[54]

As of April 1981, 592 medium and large projects were under construction. More than half of them were for the lagging light industry, textiles, energy, transport, and building materials sectors. Sharp cutbacks in capital construction will not reduce investment in the medium and large projects of the textile and other light industries—1981 investment in these projects is to continue at the previous year's level.[55]

At the same time, the central government decided to reassert itself in the planning and managment of capital construction. From now on, all projects will be included in the state construction plan. All medium- and large-sized projects as well as those projects funded by the state budget will be arranged by the state under unified planning, and departments and localities are not allowed to act independently. Before using investment funds outside the state budget, local governments and enterprises must obtain the approval of the central authorities regarding the purpose of investment and the scale of construction.[56] In April 1981, the State Planning Commission, the State Capital Commission, and the Ministry of Finance jointly issued regulations prohibiting the construction of projects considered uneconomical, undesirable, or not carefully planned.[57]

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[51] In 1957 Chen Yun pointed out that the scale of capital construction should be compatible with the country's capabilities. The following statement that Chen made at that time has been quoted frequently in recent Chinese press articles: "The scale of construction should tally with the country's financial and material resources. This is the demarcation line between a stable and an unstable economy. Economic stability is very important for a country like ours with a population of 600 million. When the scale of construction surpasses the capabilities of the country's financial and material resources, the economy will be chaotic. If these two conform with each other, the economy will be stable." (Special Commentator, Capital Construction Must Be Centralized and Unified to a High Degree During the Period of Readjustment", Renmin Ribao, December 30, 1980, p. 5.

[52] Yao Yilin, "Report on Readjustment of 1981 National Economic Plan and State Revenue and Expenditure to the 17th Session of the 5th National People's Congress Standing Committee", Renmin Ribao, March 8, 1981, pp. 1, 3.

[53] Renmin Ribao, May 8, 1981, p. 1.

[54] Yao Yilin, op. cit.

[55] Renmin Ribao, April 10, 1981, p. 1.

[56] Editorial, "Totally Carry Out and Resolutely Implement the Guidelines for Readjustment", Renmin Ribao, December 2, 1980, p. 7.

[57] Renmin Ribao, April 3, 1981, p. 1.

Investment responsibility will be assigned to three levels of government according to the nature of the project. Investment in large, costly long-term projects, such as major energy conservation programs, big coal mines, oilfields, electric power stations, main railways, important harbors as well as large-scale projects for harnessing rivers, will be provided primarily by the central government, and construction will be carried out in cooperation with local governments. Investment in projects in agriculture, the light and textile industries, the buildings materials industry, urban public utilities, environmental protection, commercial service trades, culture, education and public health facilities will be provided primarily by local governments, and some of them may be carried out jointly by local governments and central ministries. Local departments and enterprises will invest primarily in workers' housing facilities and projects designed to improve production safety, environmental protection, energy conservation, and the variety and quality of products.[58]

Reduction in the scale of capital construction is accompanied by shifts in investment priorities. Larger shares of investment resources will be allocated to agriculture, light industry and projects having direct bearing on consumers' well-being such as housing, urban public utilities, and health and educational facilities.[59] Although a smaller amount of investment funds is allocated to heavy industry, the investment shares in energy, building materials, transport and communications will not be reduced.

III. FOREIGN TRADE AND TECHNOLOGY ACQUISITION

The Great Leap Outward

In pursuit of the four-modernization objectives, the post-Mao leadership envisioned a development model to integrate potentially large infusions of foreign capital and technology into the Chinese economy to stimulate its growth. The core of the ill-conceived, over ambitious 10-year economic program unveiled in 1978 called for construction of 120 major projects including 10 iron and steel complexes, 9 nonferrous metal complexes, 8 coal bases, 10 oil and gas fields, 30 power stations, 6 new trunk railways, and 5 key harbors to be completed or underway by 1985. These projects were to rely heavily on plant, equipment and technology imports.

To facilitate these imports, China signed long-term trade agreements (LTTAs) with Japan, France and the United Kingdom. Under the Sino-Japanese LTTA signed in February 1978, China would export to Japan $10 billion worth of crude oil, coking coal, and steaming coal in exchange for $7-8 billion worth of Japanese plants and technology and $2-3 billion worth of Japanese machinery and construction materials. In march 1979, the two countries agreed to extend the LTTA by 5 years with two-way trade to total $40-60 billion over the 13-year period, 1978-90.

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[58] Ibid; and Special Commentator, Renmin Ribao, December 30, 1980, p. 5.

[59] According to Chinese usage, one way of classifying investment in capital construction is a division between productive and nonproductive projects. The later refers to those not directly related to production such as housing, urban public utilities, and facilities for scientific research, education, culture and public health. During the First FYP, the "nonproductive" share of capital construction investment came to 28.3 percent. But this share declined substantially in subsequent years, reaching as low as 10.6 percent during the latter half of the 1960s. The post-Mao years saw significant increases in "nonproductive" investment in capital construction with the share gradually rising from 13.2 percent in 1976 to 16.7 percent in 1977, 17.4 percent in 1978, 27 percent in 1979, and 33.7 percent in 1980. Increases in housing investment were particularly rapid in recent years, with the share in total capital construction investment rising from 6.9 percent in 1977, to 7.8 percent in 1978, 14.8 percent in 1979 and 20 percent in 1980. (Renmin Ribao, January 2, 1981, p. 1; Beijing Review, no. 9, May 11, 1981, p. 26; and Wu Jiang, "Another Study of the Basic Economic Law of Socialism", Hongqi, no. 12, June 16, 1980, pp. 1–18.)

In December 1978 China reached a 7-year, $13.6 billion LTTA with France to provide a basic framework for Chinese acquisition of French capital equipment and technology in a number of areas including metals, electric power, petroleum, transport, space and hotels. In exchange for these imports, China was to export to France oil, coal, and nonferrous metals in addition to traditional products such as foodstuffs, textiles, silk, and handicrafts.

A similar LTTA was concluded between China and the United Kingdom in March 1979, calling for bilateral trade to total $14 billion over the period 1979-85. China did not sign a LTTA with the Federal Republic of Germany, but the value of Chinese orders under negotiation with West German firms during 1978 reached substantial levels.[60]

At the time when these LTTAs were negotiated and signed, Chinese planners appeared to have envisaged a number of new ways of generating foreign exchange income to pay for capital goods and technology imports. They hoped to expand export earnings substantially through development of underground resources, especially oil, coal, and nonferrous minerals. Negotiations were started with foreign firms for construction of projects that were eventually to become new Daqings (China's largest oilfield with 50 million-ton annual output), major coal bases, or large ferrous or nonferrous metal complexes.

Foreign exchange income was to be expanded also through an effort to attract more overseas remittances and promote tourism. Foreign companies were invited to China to discuss possibilities for hotel construction, and a number of preliminary agreements were quickly reached.

At the same time, China dropped its ideological opposition to the use of credit as well as to foreign investment in China. Since 1978 the PRC has reached major credit agreements with Western government credit agencies and commercial banks totalling nearly $30 billion. Most of these agreements were arranged during late 1978 and the first half of 1979. A joint venture law was promulgated in July 1979 to provide a legal framework for joint ventures with foreign equity participation.

China also adopted a number of innovative arrangements with foreign businesses such as export processing, compensation trade and special economic zones. To improve the efficiency of conducting international business, steps were taken to decentralize the foreign trade structure. A number of provinces and special municipalities were granted greater authority to handle foreign trade and investment. Trading corporations were established under nearly every ministry with production facilities.

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[60] The largest deals involved a $4.3 billion protocol for a German consortium to design and erect in China two open-pit coal mines, five new shaft mines and several coal mining equipment manufacturing plants, and an agreement with Lurgi to build 22 nonferrous metal projects. China signed $800 million contracts with West German firms for five petrochemical plants, a $217 million contract for a polyester plan, a $100 million contract, for five chemical plants and a $97.5 million contract for four air separation plants.

Under the expansionary economic policy, commercial contacts between China and the West increased rapidly. A large number of contracts were consummated and numerous initial agreements including letters of intent, memoranda of understanding and protocols were signed. In 1978 alone the cost of equipment and technology contracts for Chinese construction projects came to $7.8 billion.[61]

Impact of the Retrenchment

The impact of the retrenchment was first felt in early 1979 when many import contracts signed with Japanese companies after December 15, 1978 were temporarily suspended. This was the direct result of the initial evaluation of the 1978 capital construction program. Although these contracts were restored later, the pace of commercial negotiations between China and other countries slowed considerably. Negotiations were halted on certain projects, such as those for hotel construction, despite the existence of preliminary agreements with foreign companies.

After the capital construction program was subject to a further evaluation in 1980, many more projects, including those involving foreign participation, were stopped or delayed. Included were a number of projects which American comapanies had agreed to build, or had participated in design and engineering studies, such as the foreign trade center in Beijing, a copper mining and processing project near Dexing in Jiangxi Province, the Pingguo aluminum complex in Guangxi Zhuang Autonomous Region, and the iron ore development projects in Shuichang and Sijiaying in Hebei Province and Nanfen in Liaoning Province. In late 1980 China decided to terminate or suspend construction of several more major projects which involved $2.5 billion worth of contracts with Japanese, West German and other foreign companies. The contracts with Japan, worth about $1.5 billion, were for the second stage of the Baoshan steel project near Shanghai and plants for four petrochemical complexes: Nanjing in Jiangsu Province, Shengli in Shandong Province, and Yanshan and Dongfang both in Beijing.

Since China began to retrench its capital construction program, the number of plant contracts signed with foreign companies has diminished substantially. In 1978 complete plant contracts were signed for 22 major projects. But in 1979 contracts were signed for only four projects—two electric power stations and two cement plants. During 1980, no contracts were signed for medium and large-sized projects.[62]

Project cancellations and postponements appear to have dampened much of the enthusiasm that Western businessmen had originally held for the China market. The abrupt suspension of plant contracts has reduced further such enthusiasm, and shaken the confidence of many Western businessmen in the Chinese economy and the leadership's ability to develop it. Certain foreign officials are reported to have cautioned the Chinese that their unilateral suspension of contracts were having adverse effects on China's credibility as a trading partner, and on its future economic relations with the countries affected by Chinese actions. Many foreign companies are reassessing their China operations; some of them with representation in Beijing have reduced staff size, or have withdrawn completely.[63]

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[61] "Import-Export Commission Vice Minister Wang Daohan Talks about Economic Cooperation and Technical Exchange", China's Foreign Trade, no. 3, May-June 1980, pp. 2-3.

[62] Renmin Ribao, May 16, 1981, p. 2. Japan which is China's largest supplier of plants and technology was only able to obtain about $150 million in new plant contracts besides those for the second stage of the Baoshan steel project, which has now been suspended. These contracts involved only small-scale facilities for manufacturing products such as aluminum foil, fluorescent lamps, and battery. See Sueo Kojima," China Toughens Readjustment", The JETRO China Newsletter, no. 30, February 1981, pp. 8–13.

The PRC is keenly aware of the undesirable impacts that its recent actions have brought about. Beijing has made it known that it will continue to make cash payments to Japanese suppliers according to the original terms of the petrochemical orders.[64] To shore up Western confidence, Chinese leaders have taken pains to repeatedly assure foreign visitors that China's open economic policy has remained unchanged, and that the ongoing readjustment will put the Chinese economy on a firmer ground for future cooperation with other countries.[65] Similar explanations were given by Chinese officials at the March 23-28 Hangzhou World Economy Symposium which was attended by some 80 Western business executives, by a delegation led by Vice Premier Gu Mu at the March 30-April 10 European Economic Community-China trade week in Brussels, and by several Chinese specialists at a May 20-23 meeting in Beijing with members of the Trilateral Commission.

Current Policies

China's open economic policy has a two-pronged purpose-to supplement long-term goals of self-sufficiency with accelerated growth of certain selected sectors. The policy is designed to "enlarge foreign trade, actively utilize foreign funds, import advanced technology, and strengthen economic cooperation and technical exchange with other countries."[66] The "openness" of the policy may be seen from certain specific measures concerning (1) foreign trade; (2) the utilization of foreign funds; and (3) special economic powers for Guangdong and Fujian Provinces. Since the Chinese economy is in the midst of a readjustment process, all economic measures, including those relating to foreign trade, are expected to facilitate, or at least not to hinder, that process.

1. FOREIGN TRADE

The prevailing view among Chinese officials and specialists is that China's foreign trade is expected to expand during the readjustment period, although the rates of growth are likely to be lower than those attained in the past few years. To avoid substantial trade deficits, exports are expected to keep pace with imports. First priority, therefore, is placed on export promotion. The size of imports is to be determined by the size of exports.

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[63] "China Halts Building Pacts; Foreign Contractors Reassess Position", The Journal of Commerce, December 11, 1980; "Chinese Retrenchment Dims Foreign Firms' Hopes", The Journal of Commerce, March 1, 1981, p. 12; and "Pulling Back, Not Out: What Firms' Moves Mean to Them and To Peking", Business China, Vol. VII, no. 6, March 25, 1981.

[64] The Asian Wall Street Journal Weekly, June 22, 1981, p. 2.

[65] Renmin Ribao, January 14, 1981, p. 1; March 19, 1981, p. 1; and May 24, 1981, p. 1; and China Daily, June 2, 1981, p. 1.

[66] Ji Chongwei, "Questions concerning the Utilization of Foreign Capital and Relevant Economic Laws in China", a paper given at "Seminar on New Development Trends in China's Economy". Hong Kong, October 10, 1980.

The goal of achieving a balance between imports and exports does not imply an "absolute balance" in total trade each year, or in trade with any individual country. The criterion calls for the maintenance of a basically balanced trade with the rest of the world over a period of time.[67]

a. Imports

China traditionally has relied only on imports to acquire advanced equipment and technology needed for industrialization and to compensate for shortfalls in domestic production. Under the impact of economic readjustment, however, imports have become highly selective with significant shifts in priorities.

Technology acquisition formerly concentrated primarily on complete plants. However, the Chinese now consider the importation of turnkey projects as an inefficient, costly way of acquiring technology. Complete plant imports, therefore, will be kept to a minimum. The Chinese believe that technology can be acquired through better and more economical means such as compensation trade, export processing arrangements, licensing and joint ventures.[68]

China's current development strategy calls for special emphasis on upgrading the technical levels of existing enterprises.[69] Top import priority, therefore, will be assigned to key equipment and parts as well as high technology products, manufacturing techniques and managerial expertise required for renovating existing facilities.

Top priority also is likely to be accorded to the import of equipment and services for petroleum exploration and development, for the expansion of coal mines, and for the development of the electric power industry. Other priority sectors to receive imported machinery and technical know-how will include railways, ports, telecommunications, building materials, and public utilities.

China is actively developing labor-intensive export projects, as well as small- and medium-sized projects which require less investment, yield quicker returns, and generate potentially larger foreign exchange earnings. These projects will likely receive favorable treatment for importing needed equipment, materials and technology.

China will try to minimize the import of machinery and equipment which can be produced domestically. Some recent press articles have used protectionist arguments to advocate import restrictions.[70] The country will probably see a continuation of imports of a wide range of equipment and parts for a while because of shortages in production facilities. However, many of these imports probably will be restricted over the longer run because efforts are likely to be made both to reduce foreign exchange spending and to foster domestic production.

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[67] Zhang Peiji, "China's Foreign Trade Development and Prospects", a paper presented at "Seminar on New Development Trends in China's Economy", Hong Kong, October 10, 1980.

[68] Jing Wei, On Technology Imports, Tianjin People's Publishing House, 1980, pp. 16-34.

[69] Editorial Department, "Prospects for China's Economic Construction in the 1980s", Zhongguo Duiwai Maoyi, no. 3, May-June 1980, pp. 2-3.

[70] Commentator, "Import Less or No Products That Can Be Manufactured at Home", Renmin Ribao, April 9, 1981, p. 2.

b. Exports

Until recently Chinese exports had played only the passive role of earning enough income to pay for needed imports. In recent years, however, exports have been assigned additional roles of stimulating domestic production and creating employment opportunities. The Chinese now consider exports useful in raising the technical levels of production, especially in agriculture and light industry. The stoppage of a large number of construction projects has increased the size of unemployment, and expanding the export sector is deemed to be an effective way of generating jobs for the unemployed.

The PRC will continue to rely on the export of a number of key traditional Chinese products such as arts and crafts, agricultural and industrial raw materials, processed food products and textiles as major sources of foreign exchange income. However, restrictive measures by importing countries are likely to impose a major constraint on the expansion of certain export, e.g., textiles.

China is making efforts to change the commodity composition of exports gradually by expanding production and sales of nontraditional items. Among them, machinery and electrical products are considered to have strong potential.[71]

Crude oil exports will almost certainly experience a decline in the next few years because of production difficulties and increased domestic requirements for energy. In the long run, coal will probably become an increasingly important export commodity if transport problems can be resolved.

Current policy calls for establishment of export processing projects, especially in coastal areas, to utilize raw materials and semimanufactures imported from abroad. This new policy of "promoting exports through imports" is thought to be beneficial to the economy in several ways. It would be able to tap the existing excess capacity of many processing plants, and would create employment opportunities. It would release some of the pressures on the domestic supply of materials. It would enhance the technical level of production by bringing domestic plants in close contact with the world market. Most importantly, it represents a quicker way of earning foreign exchange.[72]

In recent years China has set up "comprehensive export commodities" as well as "single export commodity" producing centers for farm produce and sideline products and for industrial and mineral products. In addition, special plants, workshops and mines employing new materials and advanced production techniques have been created to produce goods for exports. The first producing center was established in 1973 in Foshan in central Guangdong Province. By early 1981 the number of comprehensive centers had grown to 22, and the number of single-item centers had exceeded 100. The country now has about 100 factories and mines specialized in exports. In 1980, these units produced about 8 billion yuan worth of goods, 21.4 percent of the country's total output value of export commodities.[73]

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[71] Editorial in Renmin Ribao, February 25, 1981, p. 1; and Commentator, "Grasp Well the Supply of Goods, and Promote Exports", Renmin Ribao, April 28, 1981, p. 2.

[72] Ibid. It has been estimated that on the average processing $1 worth of imported materials can bring to China approximately an equal amount of net foreign exchange earnings. See Yan Weijin, "Foreign Economic and Trade Work Should Serve Economic Readjustment Better", Jingji Guanli, no. 3, March 15, 1981, pp. 16–18.

China also has taken measures to decentralize foreign trade decisionmaking in order to promote exports. It has allowed local enterprises to retain foreign exchange, instituted differential internal settlement rates between the Renminbi and the U.S. dollar for different export commodities, and given greater authorities for local governments and enterprises to handle exports.[74]

There are indications that the central government recently has reasserted itself in the management of certain foreign trade activities. This recentralization may have resulted partly from the policy to stress readjustment over reform, and partly from the problems caused by the reforms.[75]

2. ULILIZATION OF FOREIGN FUNDS

In June 1979 then-Premier Hua Guofeng announced in his government work report to the National People's Congress that during the period of economic readjustment, as well as in the long run, China would follow international practice in using "various reasonable forms of absorbing foreign funds." He stressed that this was a firm, major policy of the Chinese government.[76] Recently this policy has been reaffirmed by Chinese officials.[77] In the next few years, however, foreign funds will be used in the priority sectors of the economy to "serve economic readjustment". The list of priorities is similar to that for equipment and technology imports enumerated earlier. Project approval will be based on an assessment of repayment and absorptive capabilities.[78] Individual projects should either produce products competitive in international markets or be import-substitutive, and the projects should be viable in cost-benefit terms. Moreover, there should be sufficient resources domestically to support the project, both during construction and upon completion.

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[73] Department of Export Commodities Production Bases, Ministry of Foreign Trade, "Production Bases for Export Commodities", China's Foreign Trade, no. 3, May-June 1980, pp. 40-41; Daily Report-People's Republic of China, Foreign Broadcast Information Service (FBIS), Vol. 1, no. 107, June 2, 1980, p. L7; China Report-Economic Affairs, Joint Publications Research Service (JPRS), 76425, September 12, 1980, p. 65; and Zhang Peiji, op. cit.

[74] The state maintained control over exports of 17 key commodities including coal, crude oil, finished steel, and silk thread (accounting for approximately 80 percent of total exports), but allowed local trading companies to conduct exports of all other commodities independently. At the present time, however, it appears that only Guangdong and Fujian Provinces have retained this authority as a result of the recentralization.

[75] Last year, for example, a number of local trading companies engaged in a sort of price competition in their effort to promote sales. This resulted in not only losses in foreign exchange earnings, but also confusion and other problems for foreign businessmen. Thus at the Spring 1981 Guangzhou Fair, China reestablished a "unified policy" to set up a uniform price for the same product sold by different localities.

[76] Zhongquo Duiwai Maoyi, No. 6, 1979, p. 4.

[77] China Daily, June 2, 1981, p. 1.

[78] Ji Chongwei, "China's Utilization of Foreign Funds and Relevant Policies", Beijing Review, No. 16, April 20, 1981, pp. 15-20, and Liu Lixin, "Use Foreign Capital to Serve the Readjustment of the National Economy", Renmin Ribao, July 28, 1980, p. 5.

Foreign funds are being used in many different ways. A number of credit lines, for example, have been made available to China in several forms—government-to-government loans; officially backed export credits; private bank credits; and loans from the international financial institutions. Governmental loans generally have been used for financing projects in transport and energy development. The loans from the World Bank will be used for the development of infrastructure as well as agricultural projects and educational programs. Much of the $12.7 billion buyers' credits obtained from Western banks has remained unused because of the current economic retrenchment. The PRC now has a clear preference for low-interest, long-term loans and for development assistance loans to be used for infrastructural and agriculture-related projects.

China is trying to attract foreign capital through a number of innovative economic arrangements with foreign companies such as export processing, compensation trade, contractural ventures, coproduction, leasing, joint equity ventures, and international cooperation in resource development. These arrangements appeal to the Chinese because they permit the acquisition of new equipment and technology with minimum expenditure of foreign exchange.

Export processing trade began in 1977, and compensation trade in the middle of 1978. During 1980 China obtained more than $100 million worth of equipment and technology from 350 small and medium-sized compensation trade undertakings, and another $87 million from three large-scale ones.

The country now has more than 300 contractual ventures, mostly in Guangdong Province, with foreign investment totalling $500 million. Under the usual practice of this arrangement, foreign firms provide funds, equipment, and techniques while the Chinese side supplies land, factory buildings and labor, and is responsible for operation and management. The two sides share output, sales or profits at an agreed ratio, and all assets belong to the Chinese when the contract expires.

Coproduction arrangements have taken place primarily in the machinery industry. The first such arrangement was made in 1978 when the First Ministry of the Machine Building Industry signed a contract with a West German firm to coproduce oxygen generators. Other coproduction agreements have been reached with American, French, and Japanese companies. China also has started to undertake the leasing business, and its first leasing company was set up in early 1981 as a joint venture between two Chinese entities and one Japanese leasing firm.

Since the promulgation of the joint venture law in 1979, China has negotiated or discussed over 300 possible projects with companies from more than 30 countries. At the end of 1980, China's Foreign Investment Commission had approved 20 joint equity ventures with a total investment of more than $210 million, of which more than $170 million will be foreign investment.[79] China's current preference seems to be for joint ventures in small and medium-sized export-oriented projects. China also prefers to use existing facililties as a basis for joint ventures in order to minimize new investment in buildings and land.

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[79] Ji Chongwei, "China's Utilization of Foreign Funds and Relevant Policies".

China will rely primarily on international cooperation for the development of petroleum resources. The China Petroleum Company has signed contracts with Japanese and French oil companies for the joint prospecting and exploitation of oil in the Bohai Bay and the Beibu Gulf of the South China Sea.[80] The essential features of the contracts were for both the Chinese and foreign sides to share investment and risks, for China to retain a certain proportion of output, apart from operating fees, and for foreign companies to share with China the remainder of output. China will likely adopt similar arrangements for joint development of both offshore and onshore oil resources in the future. This would enable the Chinese to rely primarily on foreign capital to develop domestic resources and pay for it in resultant output.

3. SPECIAL POLICIES FOR GUANGDONG AND FUJIAN

In July 1979 the State Council granted special economic powers to Guangdong and Fujian Provinces allowing them, among other privileges, to (1) have a greater role in most economic planning and in making capital construction and other investment decisions; (2) have expanded authority over export planning and foreign trade; (3) retain and utilize for investment and other purposes all foreign exchange earnings and government revenues above certain preagreed levels; and (4) establish special economic zones to attract foreign capital and technology. Since the implementation of these "special policies and flexible measures (teshu zhengce, linghuo cuoshi)", both provinces have registered significant economic progress. Last year the gross value of agricultural and industrial output rose 8.2 percent over 1979 in Guangdong and 10 percent in Fujian, both exceeding the national rate of 7.2 percent. In 1980 provincial revenues increased 10.5 percent in Guangdong and 20.5 percent in Fujian while exports grew 27.9 percent in Guangdong and 47.2 percent in Fujian. As of the end of 1980, both provinces had signed with foreign companies over 7,000 contracts involving the use of foreign capital.[81]

Regardless of their special status, both provinces also have been affected by the current retrenchment. The central government's funding for capital construction projects in these two provinces has been curtailed, and as a result a large number of projects has been halted or deferred. Fujian's capital construction investment for 1981 is to be reduced by more than one-third from the 1980 level. However, both provinces will continue to have special economic authorities, and long-term development programs are being formulated.[82]

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[80] A project calling for the joint prospecting and exploitation of oil in the Yingehai Basin of the South China Sea is under discussion between the China Petroleum Company and American oil companies. Beginning in May 1979 China has signed agreements with 46 foreign oil companies covering a 100,000-kilometer seismic survey of South China Sea and South Yellow Sea. Another 30 foreign oil companies have participated in geophysical prospecting.

[81] New China News Agency dispatch, June 10, 1981 in World Journal, New York, June 12, 1981, p. 2.

[82] The provincial leadership in Fujian now envisages the establishment of a number of economic bases: forestry, animal husbandry, fisheries, cash crops, light and textile industries, foreign trade, and science and education. Industrial development efforts will be concentrated on labor-intensive activities during the 1980s and on technology-intensive activities in the 1990s. Industrial sectors currently selected for accelerated development include sugar refining, food

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To implement these programs will require large amounts of foreign capital, as the central government is not in a position to provide substantial financial support. Both provinces are actively seeking foreign and overseas Chinese investment. So far Guangdong appears to have had greater success than neighboring Fujian, primarily because Guangdong is more developed, is closer to Hong Kong, and has more experience in economic dealings with the outside world.

The most important feature of the special policy for Guangdong and Fujian has to do with the establishment of special economic zones (SEZs) which will be open to all sorts of foreign investment, including wholly owned foreign enterprises. These zones are to have not only industrial projects, but also agricultural undertakings, tourist facilities, laboratories and institutes, and residences. Industrial projects in the zones will be mostly in light industry, manufacturing, processing, textiles, electronics, and chemicals. At present SEZs are being set up in Shenzhen, Zhuhai and Shantou in Guangdong and Xiamen in Fujian.

In August 1980, the National People's Congress approved regulations for the operation of Guangdong's SEZs. The regulations provide for a 15 percent corporate tax rate compared to a 33 percent rate for joint ventures elsewhere in China, as well as tax holidays for certain types of investment. The regulations permit enterprises to dismiss workers according to the provisions of the labor contracts which they must sign with the workers after a trial period. In addition, preferential treatment will be given to foreign investors with regard to the use of land, foreign currency control, and the importation of goods.[83]

Shenzhen, adjacent the New Territories, is the largest SEZ and has shown the most rapid development. The zone is divided into three geographically separated areas with different functions and specializations.[84] At present, there are about 500 enterprises with varying degrees of foreign investment participation in Shenzhen. So far businessmen from 33 countries have gone there to discuss investment possibilities.[85] The SEZ in Zhuhai, near Macau, will also comprise three areas totalling 6 to 7 square kilometers, and planning is essentially completed. A number of contracts have been signed, and several joint ventures and one wholly foreign-owned enterprise are already operating. The SEZ at Shantou, the main port city of eastern Guangdong, is still in an early stage of planning. Reportedly, Hainan Island, off the Guangdong coast, will be granted special rights similar to those of an SEZ. Some of these

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processing, electronics, textiles, paper, and arts and crafts. Efforts are underway to expand infrastructure (ports, railways, airports and telephone systems) and energy supply (primarily electric power). See Fujian Ribao, April 1, 2, 5, and 14, 1981.

[83] Beijing Review, no. 12, March 23, 1981, p. 3.

[84] These three areas, totalling 327.6 square kilometers, are: Shekou, to the west on the Pearl River estuary; Futian, on the shallow bay 7 kilometers west of Shenzhentown; and the Meisha area, 20 kilometers east of Sehnzhen town on the beach at Taiping Wan. Shekou will be the heavy industrial area operated by the PRC-owned, Hong Kong-based China Merchants Steamship Navigation Company under the overall management of the Guangdong Provincial Administration for SEZs. Construction of docks and other infrastructure has been completed at Shekou, and more than a dozen factories will soon begin operation. Futian will house primarily light industrial, textile, electronic and chemical factories, many of which are already operating. The Meisha area will be developed as a resort primarily for Hong Kong residents.

[85] "The Shenzhen Economic Zone Development Well Underway" Chinese Export Commodities Fair Bulletin, Spring 1981, pp. 78-79.

rights also will be extended gradually to Guangzhou and other cities.[86]

The State Council has approved the establishment of the first SEZ in Fujian—a 2.5 square kilometer area in Huli on Xiamen island. In the initial phase of development, construction will be concentrated on a 1.1 square kilometer area. Ground leveling and construction of public utilities started in October 1981. Current plans call for the zone to begin operations in 1982. Dongdu, a new port in the vicinity of the Huli SEZ, is under construction. When completed, it will have a 12 million ton cargo handling capacity per year, with at least 20,000 tons annually in containers. Other infrastructural projects, including airports, railways and telecommunications facilities, are being expanded in Xiamen. While regulations governing the Fujian SEZs have not been published yet, they probably will be modeled on those for Guangdong SEZs. The provincial leadership in Fujian has proposed to Beijing that the entire municipality of Xiamen be designated as a SEZ. If approved, preferential treatment given to foreign investors regarding taxation, land use, foreign currency control, importation of goods and travel would be applied to Xiamen as a whole, covering a territory of 1,466 square kilometers. The vision of the current Fujian leadership is eventually to transform the entire province into a SEZ.

IV. PROSPECTS FOR FOREIGN PARTICIPATION IN CHINA'S CAPITAL CONSTRUCTION

China's Open Economic Policy in Perspective

The adoption of an open economic policy is said to be a "long-term strategic decision" made by the post-Mao leadership after they had summed up the experiences of the country's economic development during the first three decades of the People's Republic. The main elements of the policy were preached by Deng Xiaoping in the early 1970s, and were put into practice during 1977–78. It gained approval at the Third Plenum of the Central Committee of the Chinese Communist Party in December 1978.

Notwithstanding the current economic retrenchment, the leadership's commitment to the open economic policy appears to be genuine and firm. This commitment can best be understood both in the context of China's developmental needs and from a review of the evolution of Chinese foreign trade policies.

China has a large, continentally based economy with a relative scarcity of arable land and a massive population. Agriculture remains backward, unable to generate a surplus sufficient to support industrialization. Energy and mineral resources remain largely undeveloped due to lack of capital and technical know-how. Inadequate transportation and communication infrastructure not only prevents the country from an efficient distribution of food and raw materials, but creates a bottleneck for industrial growth. Thus any rational and measured development strategy for China would naturally include inputs of necessary materials, equipment, and know-how from abroad.

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[86] FBIS, March 24, 1981, p. P1; and Renmin Ribao, June 8, 1981, p. 1.

This contention is consistent with the historical experiences of developed and developing countries. Foreign capital and imports of technology and equipment typically provide the quickest, and perhaps most economical way, of accelerating growth in the development process. Without large-scale imports of Soviet machinery and equipment, for example, China's average rate of economic growth between 1953 and 1957 would have been reduced by 1.5 to 3.5 percent a year.[87]

Since the inception of the People's Republic, Chinese planners have fully recognized the useful contribution that foreign capital and technology could make to economic growth. China's foreign trade policies, therefore, have revolved around the established principle of "relying mainly on our own efforts while seeking foreign assistance as a supplementary means". Historically, these policies have gone through some rather dramatic fluctuations, reflecting changes in stages of development, economic policy and political relations with other countries.

In the 1950's, China's foreign trade depended heavily on the Soviet Union and Eastern Europe. The core of the capital construction program during the First FYP was more than 400 projects, of which 156 were designed by the Russians.[88] Plants, equipment and technology for these projects were imported from the Soviet Union with the aid of some $1.9 billion in Soviet credits. About 11,000 Soviet technicians and scientists were sent to work in China, half in industrial enterprises, 18 percent in transport and communications, and the rest in agriculture, education, public health, and scientific research.[89]

The Sino-Soviet split and the Great Leap fiasco caused China's foreign trade policy to become more inward-looking and narrower in scope. Imports declined in 1960–62 as the development strategy shifted toward more labor-intensive methods of production in part because of the withdrawal of Soviet technical assistance. Exports also decreased due to domestic production difficulties. During the post-Leap recovery 1963–65, foreign trade was reoriented toward Western Europe and Japan. They became the sole source of complete plant imports by the PRC.[90]

Foreign trade again became less important during the late 1960s when the Cultural Revolution created strong anti-Western feelings. In the early 1970s when the economy began to recover from the disruptions caused by the Cultural Revolution, China's trade relations with Western countries became more open and expansionary. The PRC apparently decided to launch an active program of technological imports. The value of complete plant purchases from

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[87] Alexander Eckstein, Communist China's Economic Growth and Foreign Trade, New York: McGraw-Hill Book Co., 1966, p. 121.

[88] Ji Chongwei, "Questions Concerning the Utilization of Foreign Capital and Relevant Economic Laws in China".

[89] At the same time, over 700 Soviet experts taught in Chinese Universities and technical schools, helping to establish new departments and laboratories. Some 38,000 Chinese were sent to the Soviet Union for training; half of them were workers, and the others included 7,500 students and 1,300 scientists.

[90] At that time, China purchased about $200 million worth of industrial plants from Japan and Western Europe, and was in the process of negotiating for additional facilities before the Cultural Revolution began.

Western Europe and Japan expanded sharply, reaching a peak of $1.2 billion in 1973.[91]

At about the same time, a number of Chinese press articles expressed concern over the possibility of over-reliance on imports. After Deng Xiaoping's proposals to relax the self-reliance stance became known in the latter half of 1975, the radical-controlled media launched a campaign to discredit Deng, accusing him of among other things, having practiced the "slavish comprador philosophy". In fact, no political faction in China had denied the usefulness of technology and equipment imports ; not even Deng's fiercest critics showed strong animosity toward such imports. At issue was the degree of reliance on imports and the manner of their financing.

The purge of the "Gang of Four" signified a significant shift in China's economic and trade policy. It was apparently decided that China would pursue an open foreign trade orientation to a degree unprecedented in the People's Republic. Nearly all ideological barriers to trade were gradually removed. These drastic steps were taken probably because of the recognition that the damages to the Chinese economy caused by the Cultural Revolution were so great and far-reaching that a speedy and successful recovery could not be achieved with China's own resources. This led to the Third Plenum's decision to adopt the open economic policy as part of a long-term strategy. In a sense, this decision represents a case of making a virtue out of necessity. Irrespective of the retrenchment and cutback of capital construction, the central elements in the new policy—increased foreign trade, selective use of foreign funds, technology imports, and economic cooperation and technical exchange with other countries—will continue.

Constraints on the Use of Foreign Capital and Technology

There are a number of constraining factors which will limit China's capability to absorb foreign capital and imports of equipment and technology. First of all, there is a foreign exchange constraint. The size of China's foreign exchange earnings is determined primarily by exports. (Exports constitute roughly 85 percent of China's foreign exchange earnings). In the next few years, however, Chinese exports are not likely to grow very rapidly.

Crude oil has been a leading export constituting about 15 percent of Chinese hard currency export earnings in recent years. But China's petroleum industry is plagued by major difficulties resulting from mismanagement, undercapitalization, and low productivity in the past. Output declined last year, and is expected to drop further in the next several years. Oil from offshore basins cannot be brought into large-scale commercial production much before the end of the decade. Thus it appears highly unlikely that crude oil will continue to be a major source of export earnings in the 1980s.

Traditionally, China has relied on agricultural products and on processed or manufactured goods using agricultural products as raw materials to provide about half of its export earnings. But Chinese agriculture is growing too slowly to become a major source of export expansion. China has imported large quantities of grain each year for two decades. The PRC also exports roughly 2 million metric tons of rice a year especially when the price ratio between rice and wheat on the world market is in favor of the former. However, for the foreseeable future China will almost certainly remain a net importer of grain primarily because of the inability of Chinese agriculture to yield a sufficient surplus for the urban sector, and because the Chinese are projecting longer term dietary changes for the urban population. The problem is aggravated by the fact that Chinese agriculture is still vulnerable to weather changes. Poor harvests are usually followed by larger agricultural imports, thus reducing the amount of foreign exchange available for nonagricultural imports.

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[91] The value of complete plant contracts signed during 1972-76 totalled $2.9 billion.

China is particularly rich in coal deposits. Verified reserves throughout the country now are placed at in excess of 600 billion tons. In view of the growing world demand, coal could replace crude oil as China's major export commodity. However, China's coal industry is also faced with some difficult problems due to neglect over the past two decades. The Chinese now have an active program for the development of the coal industry, and a number of coal mining projects with a total capacity of 78 million tons are under construction. When completed, they will expand greatly the exportable surplus of Chinese coal. But the main problem will be transportation. A construction program to expand railway and port facilities is underway.[92] The program is designed to increase the capacity of shipping coal from Shanxi and Inner Mongolia to Qinghuangdao, from Shanxi to Qingdao, and from the Yanzhou mines to the new port of Shijiusuo. Although these facilities, when completed, will greatly ease the transport problem, many more facilities will have to be constructed if China is to export large quantities of coal.

In the short term, therefore, the only important source of export growth is manufactured goods. Textiles and other light manufactured goods are China's key traditional export commodities, and currently are given top priority in the allocation of resources. The Chinese believe that their machinery industry can be developed into an important export sector. They also hope to develop the electronics industry by using imported equipment and techniques to produce for both domestic and foreign markets. Exports of these goods will depend on China's ability to expand production facilities and improve product quality. Competition from other supplier countries and restrictive measures by importing countries will place constraints on these exports.

China's shortage of energy and raw materials and limited manufacturing capacity for the supply of auxiliary equipment are also factors which inhibit the growth of imports. There is already evidence of underutilization at many recently imported plants, due to the lack of energy and raw materials. For example, this was clearly a major factor underlying the recent cancellation of a number of projects which would have consumed large amounts of crude oil and electric power. It has been estimated that in the 1970s, four yuan of domestic inputs were required to support every U.S. dollar of capital equipment imports.

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[92] Three rail lines—Beijing-Datong, Beijing-Qinhuangdao, and Datong-Baotou—which carry coal from Shanxi and Inner Mongolia to Qinghuangdao, are being electrified, or double-tracked, or both. Three other lines—Taiyuan-Shijiazhuang, Shijiazhuang-Dzhou and Jinan-Qingdao—which transport coal from Shanxi to Qingdao, are being doubled-tracked. Construction of a new single line from the Yanzhou coal mines to the new coal port of Shijiusuo is scheduled for completion by 1985. In addition to Shijiusuo, coal piers in Qinhuangdao are also under construction.

Finally, China's ability to absorb foreign capital and technology is constrained further by the shortage of high echelon scientific, engineering and managerial personnel. To staff the complete plants imported in recent years, the country has had to acquire many thousands of production engineers, technicians, supervisory personnel and skilled workers. To select, adapt, disseminate and develop foreign technology will require additional high-grade technical manpower to undertake adaptative and developmental research. The Cultural Revolution created a considerable gap in the supply of such manpower, severely limiting China's capability of technological absorption.

Future Outlook—Priority Projects for Foreign Participants

Despite China's greater "openness" toward foreign trade and investment, the current economic retrenchment, coupled with various constraints on repayment and absorptive capabilities, will limit the immediate and short-term (1–5 year) prospects for large-scale participation in Chinese capital construction projects. In the next few years, however, significant business opportunities could appear in a number of selective projects. Although detailed plans have yet to be published by the Chinese government, certain priority sectors are clearly discernible.

During the current FYP (1981–85) which is centered on the readjustment of China's basic economic structure, prospects exist for varying degrees of foreign participation in the following projects:

Renovation of existing facilities;

Exploration and development of energy resources, especially electric power, coal and oil;

Construction and expansion of transport and communication facilities, expecially railways, ports and telecommunications systems, and infrastructural projects in cities and industrial zones;

Certain lagging industries such as construction materials and packaging materials;

Educational and scientific research facilities;

Small and medium-size projects which require less investment, yield faster returns and generate potentially larger export earnings, such as those in light industry, the textile, chemical, metallurgical, machinery and electronics industries and tourism;

Agricultural projects (farming, forestry, water conservancy, livestock, and fisheries);

Some of the ongoing projects which have been stopped or deferred owing to a lack of funds.

The key to foreign participation in China's capital construction appears to be financing. As noted earlier, China has come up with different new arrangements with foreign companies for various projects because of shortages of both domestic capital and foreign exchange. Generally speaking, Chinese projects with potential for foreign participation may be grouped into four categories according to type of financing arrangements.

One category consists of large-scale projects requiring a lengthy gestation period, yielding low rates of returns and earning no foreign exchange. Included are projects in electric power, transport and telecommunications, agricultural infrastructure and education. To the extent that these projects will require foreign equipment and technology, the current Chinese preference is to seek financing through long-term, low-interest or free loans with the government's guarantee of repayment. Since these loans are hard to obtain, the Chinese appear to have not ruled out the use of somewhat higher-cost government loans, such as Export-Import Bank credits, to finance the purchase of badly needed equipment and technical services.

At present, China has two soft-loan agreements. The Belgian Government has offered an interest-free loan equivalent to $31.5 million to be repaid in 30 years. It will primarily be used to finance the purchase of generating equipment for two 300-megawatts (MW) coal-fired power plants near Pingdingshan.

The other soft-loan agreement was reached with Japan in early 1980, Japanese yen-denominated loans amounting to 350 billion yen ($1.75 billion), to be paid out over five years from Japan's Overseas Economic Cooperation Fund, are used to cover the foreign exchange cost of six construction projects: two ports, three railways and one power station. The annual interest rate was set at 3 percent, with repayment to begin in the 11th year and complete in the 30th year. The two ports are Qinghuangdao and Shinjiusuo. The former involves construction of coal piers while the latter is to be a new port capable of accommodating 100,000-ton vessels. The three rail projects involve construction of a new single-track line from the Yanzhou coal mines to the new coal port of Shijiusuo, and double-tracking and electrification of two existing lines—the Beijing-Qinhuangdao and Guangzhou-Hengyang Railways. The power project is to be the 1,500-MW Wuqiangqi Hydroelectric Power Station in Hunan Province designed to assist in mining and forestry. Construction projects for the ports and railways are well underway, except for the Guangzhou-Hengyang line which will take several years to be completely doubled-tracked and electrified. It appears now that the Wuqiangqi power project will be delayed because of the current retrenchment.

The Chinese government is consulting with the World Bank on the first batch of loans, to be used mainly for projects in education, agriculture, electric power and port development. A $200 million loan has been approved for financing purchases of equipment used in university education. Approval is pending for a hydroelectric power station in Yunnan Province, for an agricultural project in Hebei, and for the expansion of three ports including Huangpu near Guangzhou and Xingang near Tianjin.

The PRC has an agreement with the United States for technical cooperation in China's hydroelectric power development. An American delegation which visited China in the spring of 1980 was briefed on Chinese plans for a number of hydro-power projects including those for Ertan and Jinping on the Yalongjiang River, Tianshengqiao on the Nanpanjiang River and Lontan, Yantan, Dahua and Datengxia on the Hongshui River. At that time, the Chinese expressed their willingness to have American financial and technical assistance in the development of some of these projects. It appears now that the Ertan, Jinping and Longtan projects will be delayed. The Dahua station is under construction. Construction of the Tianshengqiao, Yantan and Datengxia stations will probably start during the current FYP.

The 1,200-MW Datengxia station is designed to supply electricity mainly to Guangdong Province which has great unmet demand for electric power. A nuclear power plant has been proposed for the province and negotiations have been undertaken with several foreign companies.

The second category includes large-scale projects which require lengthy gestation periods but are potentially capable of yielding high rates of returns and generating, or saving, substantial amounts of foreign exchange. Most of the projects in this category have to do with construction or modernization of coal mines or exploration and development of petroleum resources. Natural gas and nonferrous metal projects could be included in this category, if they are assigned top priorities in the short term.

China has obtained a $2 billion, 15-year loan at 6.25 percent from Japan's Export-Import Bank. The loan will be used primarily for oil exploration and coal development projects. The Chinese are likely interested in receiving more resource development loans on similar terms. But the chief financing methods that Chinese planners seem to have envisaged for the development of coal and oil resources are various forms of international cooperation, such as compensation trade, product sharing, joint ventures and other similar devices. The main idea is to employ foreign capital and technology through these devices, and repay them in future output.

Under China's current development plans, special emphasis is placed on the expansion and modernization of existing coal mines and the construction of new ones. Foreign participation has been sought for most of the eight major coal bases. Four are in China's old mining areas—Kailuan in Hebei, Datong in Shanxi, Pingdingshan in Henan and Xuzhou in Jiangsu, and four are newly established—Liupanshui in Guizhou, Lianghuai (Huainan and Huaibei) in Anhui, Yanzhou in Shandong and Huolinhe in Inner Mongolia. Discussions also have been held with foreign companies, including Japanese, British, American, and German ones, on the development of certain mine sites outside those bases, notably Gujiao and Pingshuo in Shanxi, and Jungar and Yiminhe in Inner Mongolia.

Until the Japanese Eximbank loan agreement was signed in May 1980, foreign involvement in China's coal development had been limited primarily to equipment sales and technical studies. Among the latter the most significant one was the design of the Huolinhe coal base, an open-pit mining complex of 20 million tons capacity, by two west German firms. A British firm conducted a feasibility study for one mine in the Datong complex.

The untied Japanese Exim funds will be used to finance the construction of seven coal mines. Four of them are in the Gujiao district in Shanxi—Xiqu, Malan, Zhenchengdi and Sitaigou; two in the Yanzhou complex in Shandong—Baodian and Jiangzhuang; and one in the Kailuan complex in Hebei—Qianjiaying.[93]

Reportedly, China has held discussions with British and French companies on loans to develop Chinese coal mines. China has also discussed with an American company, the Occidental Petroleum Corporation, about possible cooperation in the development of the Pingshuo mine. In addition to coal mine development, China has also discussed with foreign countries for assistance in the development of the gasification and liquefaction of coal.

Faced with the prospect of stagnant oil production levels in the next several years, China's needs for foreign assistance in oil exploration and development has become urgent. At present, the PRC has four contracts with Japanese and French companies for joint exploration in the Bohai Bay and the Beibu Gulf of the South China Sea. Under a Sino-Japanese agreement, Japan will assume about $200 million in exploration costs and each side will share almost equally the cost for development. In return, Japan will receive slightly more than 40 percent of the oil when it comes on stream. The agreement reached with two French companies, Total and Elf-Aquitaine, calls for these companies to pay 49 percent of the exploration and development costs and take a share of production.

The terms used in China's agreements with Japanese and French companies are likely to become a model for Chinese contracts with the foreign oil companies in the upcoming negotiations. Beginning in May 1979 some 46 foreign oil companies participated in a 100,000-kilometer seismic survey of the South China Sea and South Yellow Sea. These companies were willing to pay for the cost of the surveys in hopes of eventually obtaining development and production contracts. The survey work has been completed, and relevant data have been submitted to the Chinese authorities. The PRC is expected to invite all of these companies to enter for the bid on the exploration contracts soon.

China also has invited a number of foreign oil companies to enter into joint development of the onshore resources. Several oil companies including Exxon Corporation, Occidental Petroleum Corporation, Union Oil Company of California, Conoco Inc., Tenneco Inc., ENI (Italy), the Romanian State Oil Company, the Japan National Oil Corporation and Shell Oil Company and Royal Dutch/Shell have sent experts to visit onshore oilfields and newly opened areas.

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[93] The Xiquo mine has 570 million tons of verified deposits, and is designed to produce 3 million tons of coking coal a year. Construction started in 1978 and completion is scheduled for 1987. The Malan mine has 1.05 billion tons of verified deposits, and will have an annual production capacity of 4 million tons of coking coal. The development is scheduled for 1980-1987. The estimated deposits at Zhenchengdi are put at 380 million tons. Construction of 1.5 million ton mine started in 1980 and is to be completed by 1987. The designed capacity of the Sitaigou mine is 4 million tons of coking coal, and the construction period is scheduled for 1980-1988.

Coal reserves at Baodian are estimated at 570 million tons. The mine is designed to produce 3 million tons of coking coal a year; construction started in 1977 and is to be completed by 1986. The Jiangzhuang mine has verified deposits of 300 million tons, and will have an annual designed capacity of 1.5 million tons of steaming and coking coals. Construction began in 1979 and the target date for completion is 1986.

The Qianjiaying mine, located southwest of the Kailuan complex, has proved reserves of 520 million tons. The mine has a designed capacity of 4 million tons of coking coal a year. Construction started in 1979, and is scheduled to be completed in 1987.

The Chinese have two contracts with foreign companies—one French and one American (Geosource of Houston)—to conduct seismic surveys in Xinjiang and Qinghai.[94] China's Oil and Gas Exploration and Development Corporation signed a contract with Parker Drilling Company of Tulsa, Oklahoma, for directional drilling in the Western part of Karamay oilfield in Xinjiang. This is believed to be China's first onshore drilling contract with a foreign company.

In the short term, China is likely to concentrate its efforts on offshore development because of the shortage of personnel and finances. Onshore seismic exploration is much more costly—estimated at $5,000 per linear kilometer in contrast to $500 per linear kilometer for offshore exploration. Most of the foreign companies would only consider undertaking onshore surveys on an at-cost basis. Further, it would require an enormous expense in transport infrastructure to bring crude oil from the country's far west fields to eastern markets or ports. China's current economic retrenchment precludes a plan for transport development on such an ambitious scale.

A third category includes smaller-scale projects which require shorter construction periods, yield higher and quicker returns on investment, and are potentially capable of earning or saving foreign exchange. Foreign participation in these projects may take a variety of forms including export processing, compensation trade, cooperative production, contractual ventures and joint equity ventures. Generally, these projects tend to be labor intensive and export-oriented, and most of them are likely to be located in coastal provinces, especially Guangdong and Fujian. The projects can be agricultural undertakings, tourist facilities, residences and industrial plants. Industrial projects will be mostly in manufacturing, processing, textiles, electronics and chemicals.

The utilization of foreign funds for a project, no matter what its form may be, will be made on the basis that both repayment and payment of profits have to come from the earnings of the project. In principle, part of the output of an enterprise with foreign participation must be for export so that foreign exchange earnings can cover the payment for imported materials, foreign investors' profits, and the salaries of foreign employees. In other words, the viability of the enterprise depends on its ability to achieve a balance of payments in foreign exchange.[95]

By the end of 1980, China had arranged 20 joint equity ventures, more than 300 contractual ventures and over 350 compensation trade projects. Through these means, foreign capital, equipment and technology valued at some $860 million had been introduced to China.[96] In hopes of attracting more foreign capital and technology, the Chinese are in the process of formulating additional commercial and economic laws and regulations to provide more incentives for foreign investors.[97] The extent of foreign participation in the next few years will be of particular importance in determining the degree of success of the special economic zones in Guangdong and Fujian.

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[94] The latter contract calls for Geosource to provide and operate three completely equipped seismic crews and a data processing center, and to supervise and train personnel from the China Petroleum Company in the central part of the Qaidam Basin in Qinghai. For details, see Dori Jones, "Enticing Foreigners Island", *The China Business Review*, Sept.-Oct. 1980, pp. 50-52.

[95] Ji Chongwei, "China's Utilization of Foreign Funds and Relevant Policies".

[96] Ibid.

The final category of projects is those designed to upgrade existing facilities. China now has about 380,000 industrial and transport enterprises. But most of them, including more than 4,000 large and medium-sized key enterprises, are backward in production techniques and management methods. The Chinese now believe that technical renovation of these enterprises would represent a more efficient way to improve domestic production capacity than constructing new plants. A large share of state investment funds has been allocated for the renovation program.

China has selected 130 industrial projects to be discussed with foreign companies in an investment promotion conference at Guangzhou in June 1982. With a few exceptions, these projects will involve mainly refurbishment and expansion of existing facilities. In addition, a number of provinces and municipalities have prepared their own lists of existing plants designated for cooperation with foreign companies. Such cooperation may take different forms including compensation deals, joint ventures, coproduction and technology licensing.

The earliest example of a compensation trade arrangement was a trilateral deal involving a Hong Kong firm and an American company, Container Transport International, to produce marine containers in two Chinese plants. More recent examples are the Shanghai Aircraft Factory's contract with McDonnel Douglas to supply doors for DC 9 jets and the Dalian Shipyard's contract with Baker Marine of Houston to manufacture parts for two oil rigs and repair a third one.

One of the first joint venture agreements was between China Construction Machinery Corporation and Schindler Holding AG, Switzerland and Jardine Matheson & Company, Hong Kong, to form China-Schindler Elevator Company, Ltd., using existing plants in Beijing and Shanghai. The agreement called for a continuous technology transfer over a 20-year period. More recently, several joint venture agreements have been reached with Japanese, American and German firms using Chinese existing plants to produce such products as process-control instruments, vacuum pumps, pharmaceuticals, and television sets. In all of these agreements, China is assured of the transfer of manufacturing know-how for a considerable period of time.

China has a number of coproduction agreements with Japanese, American, German and French firms. The most important agreement so far appears to be the one signed with the French company Aerospatiale for joint production of French Dauphin helicopters at a Harbin factory. The engines will be built at a plant in Zhuzhou, Hunan Province. Both factories will produce under license for an additional three-to-four-year period after the current contract expires in 1985.

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[97] He Qu, "The Creation and Development of Joint Enterprises Using Chinese and Foreign Capital", Zhongquo Duiwai Maoyi, no. 3, May–June, 1981, pp. 2–3.

To upgrade existing plants especially in the machine-building industry, the Chinese recently has made a wide variety of technical assistance arrangements, including licensing, with foreign companies. In most cases, these arrangements were made in association with compensation trade, joint ventures and coproduction. In a few cases, however, foreign suppliers will be paid fixed lump-sum licensing fees without any commitment to buyback.

Payment of cash for licenses is illustrated in the contracts with Westinghouse and Combustion Engineering signed in late 1980 to produce advanced turbines, generators and boilers in China under license. Both American firms will supply the majority of components to be assembled at five Chinese factories—a turbine factory and a boiler factory each in Harbin and Shanghai and a boiler factory near Beijing. Another example may be seen in the agreement between the China Machine Building International Corporation and Allis-Chalmers for the American company to assist the Chinese to upgrade hydraulic testing laboratories in Heilongjiang, Sichuan and Tianjin.[98]

The long-term (5-10 years) prospect for foreign participation in China's capital construction will hinge on the PRC's success in acquiring foreign capital and technology through various arrangements for the projects in the above four categories in the next few years. That success will greatly facilitate the current readjustment process, and a successful readjustment will almost certainly mean a greatly increased role for foreign capital, equipment and technology in China's development planning. That success also will increase China's repayment and absorptive capabilities, as well as its confidence and experience in implementing a more open approach.

Looking beyond 1985, it is almost impossible, even for Chinese planners, to suggest a list of specific projects requiring the participation of foreign business. Detailed priorities for 1986-90 will be determined on the basis of the results of implementing the current FYP. Therefore, much will depend on what will have happened in the next five years. But it may be instructive to discuss in broad terms the long-term prospect for some of the currently favored sectors.

It appears almost certain that both energy and transport will remain top priority sectors in the long run. This is not only because both sectors are of critical importance in economic development, but also because both are grossly underdeveloped in China. Further, both require lengthy development time, and will likely continue to be an important part of any capital construction program in the next 10 years and beyond.

China has a long-term program for the development of hydroelectric power. Two big power projects have been proposed for the middle reaches of the Huanghe (Yellow) River—the 1,500 MW Longmenxia station in Shanxi Province and the 1,600 MW station at Xiaolongdi in Henan Province. The Three-Gorge water project along the Changjiang (Yangtze) River, the largest construction project ever contemplated in China, has been under consideration for more than 20 years. The largest hydroelectric base in China is being planned on the banks of the Jinshajiang River from Shigu in Yunnan Province to Yibin City in Sichuan Province. There would be 8 hydro-power projects with a total of 49,000 MW planned capacity. Some 10 hydro-power projects with a total planned capacity of 17,000–19,000 MW are being planned on the Yalongjiang River in Sichuan Province. Another hydroelectric base with about 10 stations is being designed for the Nanpanjiang and Hongshui Rivers to provide energy needs for economic development in Guangdong and Guangxi.

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[98] For recent discussion of technology transfers to China, see Dori Jones, "Recharging the Electric Power Sector", and Martin Weil, "Technology Transfers", both in *The China Business Review*, March-April 1981, pp. 9-13, and pp. 21-28.

Over the next 10 to 20 years, the Chinese plan to build a number of coal-fired power plants. A new steam power base is forming in the Datong coal mining area in Shanxi Province. Another steam power base is developing in the important coal centers of Huainan and Huaibei in Anhui Province. A third base is to be at the new Yanzhou coal complex in Shandong Province. China is planning to develop a six-plant site in Pingdingshan, Henan Province where two thermal power plants have already been constructed. In addition, the Chinese have plans to build thermal plants in the coal complexes of Huolinhe, Yiminhe, Xuzhou and Liupanshui. A 1,200 MW thermal power plant is being planned for Guangdong Province; this plant, the Shajiao Power Station, will be located in Humen Commune in Dongwan County near the mouth of the Pearl River.

China is beginning to consider a long-range nuclear energy program. A number of Chinese nuclear specialists have recommended the construction of six 900–1100 MW nuclear power plants by 1991—two plants in each of three locations: Guangdong, Shanghai and Liaoning Province.

The long-term prospect for international cooperation in China's coal mine development appears to be quite promising. The Chinese have sought such cooperation in the form of compensation trade, product sharing, or joint venture in a number of "long-range priority" mines. The most important of these mines are:

Jungar Banner in Inner Mongolia—New coal deposits with proven reserves of some 14.6 billion tons have been discovered in an area of 1,723 square kilometers. China hopes to develop the Jungar mines into a producer of 40 to 50 million tons of steam coal annually by 1990.

The Yiminhe mine in Inner Mongolia—The mine is to have a designed capacity of 10 to 20 million tons annually, including 3 million tons of brown coal. A liquefaction plant is being planned there, perhaps using Japanese or West German technology.

The Huolinhe coal base in Inner Mongolia—Earlier plans called for joint development of new pits and open-cut mines with foreign companies in the form of compensation trade or joint ventures.

Two mines—Xishigou and Tonglan—in the Gujiao district of Shanxi Province were earlier proposed as compensation trade or production sharing projects. The production capacity would be 3 million tons of coking coal at Xishigou, and 4 million tons at Tonglan.

By the late 1980's offshore oilfields are likely to begin commercial production on a significant scale. Emphasis will probably then shift to onshore oil search. As noted above, onshore exploration and prospecting work have already been stepped up, and some technical assistance and equipment supply contract have already been signed. But extensive infrastructure development will be necessary to make commercial production in the remote fields feasible.

Among the prospective onshore oilfields, the following appear to have good potential: the Junggar and Tarim basins in Xinjiang; the Qaidam Basin in Qinghai; Erdos in the Shaanxi-Gansu-Nigxia-Inner Mongolia region; the Sichuan Basin; the Nanpanjiang area in Guangxi, Guizhou and Yunnan; northern Jiangsu Province; and the Dagan oilfield in Hebei Province.

China's current transport policy seems to center on the modernization and expansions of existing railways and ports. In the latter half of this decade, transport development will likely continue to focus on railways and ports if foreign trade as well as coal and oil development plans are to proceed as projected. But emphasis is likely to shift to construction of new facilities. Highway development probably will be given greater attention. The PRC now has a 10-year program to expand existing roads and build new roads and expressways.

Besides the energy and transport sectors, some of the projects which have been postponed because of the retrenchment may see green light again. Among them are a number of nonferrous metal projects. China is grossly deficient in nonferrous metal production, and has become more reliant on imports to meet industrial growth requirements. Yet the country is endowed with large deposits of such minerals. The original blueprint for the establishment of nine nonferrous metal complexes was designed with the aim of enabling China not only to become self-sufficient in these metals but also to earn foreign exchange through sales abroad. The PRC had earlier discussed compensation trade arrangements and construction projects with several American, Japanese and European firms. Under the impact of the retrenchment and cutback in capital construction, many of these projects, expecially large-scale ones, have been put in limbo especially in view of the large requirements for energy and for logistic and transport support by nonferrous metal production.[99] If the energy and transport situation will both improve appreciably in the next few years, some of the nonferrous metal projects, at least on a reduced scale, are likely to revive in the latter half of the 1980s.

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[99] It appears that China is still actively seeking foreign capital and technology for certain nonferrous metal projects. Lei Renmin, Vice Chairman of the Board and Vice President of the China International Trust and Investment Corporation, told members of the Trilateral Commission at the Beijing meetings in May 1981 that at present the CITIC is giving investment priority first to projects [illegible] the exploitation of nonferrous mineral resources along with that of coal.

CHINA'S HARD CURRENCY EXPORT POTENTIAL AND IMPORT CAPACITY THROUGH 1985

By Damian T. Gullo*

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SUMMARY

Since the announcement in 1978 of China's much publicized modernization drive, Beijing (and the West) have come to realize better the major economic problems facing the PRC. As a result, Beijing was forced to shelve its overly ambitious Ten-Year Economic Plan (1976-85) in favor of a slower and more pragmatic approach. Many of the large investment projects in the original plan have been scaled-down or cancelled; investment in agriculture and light industry has been increased at the expense of heavy industry; and 1985 production targets for key commodities such as oil, coal, and steel have been put off until at least 1990. The "readjustment" program, which was launched in 1979 and originally scheduled to last three years, also is aimed at correcting an over-commitment of resources to capital construction projects and eliminating sectoral imbalances, low productivity, and a poor hard currency position.

Although Beijing has not yet unveiled the 1981-90 economic plan, it will likely call for the continuation of retrenchment policies at least through 1985. China probably will concentrate on overcoming bottlenecks in the economy, spurring the expansion of export industries, and improving living standards. In addition, capital construction is expected to be held down over the next several years. The modernization and expansion of existing facilities should continue to take precedence over whole-plant purchases. High priority probably also will be given to projects that require less hard currency, provide a quicker return on investment, and offer potentially greater export earnings.

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This paper is based on information available as of the spring of 1982.

The level of China's purchases in the West over the next four years depends on the PRC's import requirements and what it thinks it can afford. In turn, China's hard currency import capacity—or what it can afford to buy in the West—will be determined by the amount of foreign exchange the PRC receives from the sale of goods and services; overseas remittances, tourism, and commercial earnings; direct foreign investment; and Western credits, less the servicing of past debt and additions to foreign reserves.

China's hard currency exports to the West—the PRC's major source of foreign exchange—are expected to slow in 1982-85, largely because of Beijing's efforts to improve living standards, shortfalls in oil production, and growing Western protectionism. Exports of manufactures, especially textiles and other light industry goods, should continue to be the driving force behind China's hard currency export growth.

Under high and low scenarios, projected Chinese hard currency import capacity in 1985 ranges from $27.8 billion to $36.2 billion. Projected 1985 exports, meanwhile, total $29.2 billion to $39.0 billion. As a result, the implied average growth rates for China's hard currency import capacity over the next five years are 11 percent and 18 percent while the rates for exports are 9 percent and 17 percent.

As in the past, China over the next five years is expected to look to the West for specific machinery, semimanufactures, and grain. The retrenchment program along with cost-cutting measures, however, should dampen the rapid growth of imports—particularly purchases of Western equipment—registered since 1970. Absorption problems and energy shortages also are expected to help hold down machinery imports.

China presumably will try to keep its hard currency trade close to balanced and minimize the use of foreign credits. Under the scenarios, and medium and long-term credit drawings over the next four years were held to $12-$16 billion, which results in a hard currency debt at yearend 1985 of $10-$14 billion. (Drawings also include credits received from cooperative production and compensation trade arrangements.) Beijing is expected to turn first to soft loans from international financial institutions and development assistance credits to help meet its financial needs.

China's trade with the U.S. in 1982-85 should continue to grow but at a substantially slower pace. Agricultural products are expected to dominate U.S. exports with semimanufactures—particularly inputs for China's light industry—probably registering strong gains.

Meanwhile, Chinese exports to the U.S. will continue to be hindered by the limited range of goods the PRC has to offer. In addition to the restricted growth of China's textile exports to the U.S. as a result of the U.S.-PRC textile agreement, domestic sensitivity in other import sectors could restrain growth. Supply constraints, on the other hand, are expected to hold down PRC sales of fuels and other crude materials.

I. INTRODUCTION

In March 1978, China unveiled an ambitious ten-year economic plan (1976–85) that incorporated the ill-fated 1976–80 five year plan and marked a sharp departure from Beijing's past commercial dealings with the West.[1] Because of the 1976–85 plan's heavy reliance on imports—particularly Western technology and equipment—China dropped ideological constraints regarding the use of foreign credits and began actively seeking joint ventures with the West, including equity arrangements. The new plan also gave more prominence to developing agriculture and light industry than in the past but still continued to favor heavy industrial growth; agriculture and light industry in 1978 accounted for only 11 percent and 5 percent, respectively, of state budget financed investment spending compared with 55 percent for heavy industry.[2]

One hundred and twenty large-scale projects, heavily dependent on imports of Western machinery and technology, were scheduled to be completed or at least under way by 1985. The ventures included 10 iron and steel complexes, 9 nonferrous metal complexes, 8 coal mines, 10 oil and gas fields, 30 power stations, 6 new trunk railways, and 5 key harbors. In addition, the 10 year plan set unrealistic 1985 production targets for key commodities such as oil, coal, and steel.[3]

Sectorial imbalances, low productivity, and a poor hard currency position, however, forced Beijing in 1979 to shelve the 1976–85 plan in favor of an economic "readjustment" program that originally was scheduled to run through 1981. As a first step toward solving the country's problems, priorities were reordered and investment for agriculture and light industry was increased at the expense of heavy industry. The lagging sectors that had constrained China's economic growth—energy, transport, and building materials industries—still were to receive high priority, however. Beijing also scaled down, postponed, or cancelled a number of the 120 major projects contained in the 1976–85 plan. In addition, the 1985 production targets for several key commodities—oil, coal, and steel—were put off for at least another five years. Emphasis was put on improving existing facilities rather than on importing whole plants. At the same time, Beijing took steps toward economic reform by giving state enterprises and local governments greater authority for decision-making and implementing incentive measures.

The retrenchment period now is expected to last until the mid-1980s since China apparently has not met the goals called for by the original 3-year economic "readjustment" program. The program has been hampered by shortfalls in the 1980 harvest and stagnant oil, coal, and electrical power output. In addition, newly instituted economic reform measures have brought new problems while failing to come to grips with some old ones. The central government's task of controlling an already overcommitted capital construction sector, for example, has been made more difficult by the decentralization of economic authority. Overspending on construction coupled with rising wages resulted in state budget deficits the past three years. The imbalances in 1979 reached a record $11.4 billion and the 1980 deficit was $7.5 billion—one and one-half times the original target.[4] As a result, China was forced into another round of cost cutting that affected both existing and new projects involving foreign firms. Projects that were cancelled or suspended included the second phase of the $5 billion Baoshan steel complex, more than a dozen petrochemical plants, and a copper smelter.[5] Japanese companies were hardest hit with over $1 billion in plant and equipment contracts affected by Beijing's decision.[6] The latest cutbacks also affected several ventures involving U.S. firms, including a trade center that was to have been built in Beijing, a large copper complex, an aluminum processing plant, and an iron ore project.

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[1] The Fifth Five-Year Plan (1976-80) was to have been the springboard for China's modernization drive. After a poor start because of political turmoil, unfavorable weather, and the Tangshan earthquake, the Five-Year Plan was incorporated into the Ten-Year Economic Plan (1976-85).

[2] The China Business Review, July-August 1979, pp. 36, 37.

[3] "China's Economic and Foreign Trade, 1978–79," U.S. Department of Commerce, September 1979.

Because of the substantial compensation payments the PRC owed Japan as a result of the cancelled petrochemical equipment contracts, however, China reversed its earlier decision and continued to import the equipment. Beijing also revived the Daqing petrochemical project and decided to complete the first phase of the Baoshan steel mill after obtaining a new soft loan package from Japan. The $1.3 billion package consists of $570 million in commodity credits to finance local construction costs, $440 million in Japanese Exim funds, and $300 million in commercial loans.[7]

Since the launching of the modernization drive in 1978, China's foreign trade has grown at a rapid pace. PRC exports to the West over the past four years have risen at an average annual rate of 32 percent and in 1981 reached a record $20.9 billion (see Table 1).[8] Rising world oil prices and Beijing's efforts under the readjustment program to increase Chinese exports of manufactures—particularly light industry goods such as textiles—largely were responsible for the strong gains.

Imports from the West during the 1978-81 period, meanwhile, rose at an average annual rate of 32 percent and in 1981 totalled $17.1 billion—roughly $300 million less than in 1980. Unlike exports, the growth rate for imports over the past four years has fallen sharply as a result of the lowering of economic goals and the adoption of the readjustment program.[9] The retrenchment program's emphasis on boosting light industry and agricultural output and improving living standards also was responsible for imports of grain, intermediate goods earmarked for light industry and agriculture, and consumer goods accounting for a growing share of China's total imports from the West.

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[4] Far Eastern Economic Review, March 13, 1981, p. 6.

[5] Business China, Business International, February 11, 1981, p. 17.

[6] Washington Post, February 11, 1981, p. A23.

[7] FBIS, September 9, 1981, p. C4.

[8] The West is defined as all non-communist countries. In addition, China's trade with the West is assumed to be hard currency trade. At least through 1981, some trade with the West was on a barter basis while a small share of trade with communist countries was on a hard currency basis.

[9] After increasing a whopping 59 percent in 1978, Chinese imports from the West rose 43 percent in 1979 and 39 percent in 1980. Hard currency imports in 1981, however, declined by roughly 2 percent.

TABLE 1.—CHINA'S FOREIGN TRADE

[In millions of U.S. dollars]

	1970	1975	1976	1977	1978	1979	1980
Total exports (f.o.b.)	2,150	7,120	7,275	8,108	10,170	13,773	19,492
West	1,680	5,755	6,050	6,754	3,524	12,018	17,533
Developed	660	2,610	2,695	2,939	3,776	5,643	8,264
Less developed	1,020	3,145	3,350	3,815	4,748	6,375	9,270
Communist	480	1,370	1,225	1,354	1,647	1,755	1,959
Eastern Europe	255	625	540	706	982	1,096	1,332
U.S.S.R	20	150	180	178	257	241	230
Other	205	590	505	470	408	418	397
Total Imports (f.o.b.)	2,045	6,830	5,580	6,598	10,351	14,383	19,316
West	1,655	5,825	4,500	5,531	8,782	12,440	17,355
Developed	1,370	4,985	3,770	4,166	7,268	10,168	13,509
Less developed	285	840	730	1,365	1,515	2,272	3,846
Communist	390	1,005	1,080	1,067	1,568	1,943	1,961
Eastern Europe	225	595	610	649	968	1,239	1,284
U.S.S.R	25	130	240	162	242	268	294
Other	140	280	230	256	358	435	383
Trade balance	105	290	1,695	1,510	−180	−610	177
West	25	−70	1,550	1,223	−259	−423	178
Developed	−170	−2,375	−1,075	−1,227	−3,492	−4,525	−5,245
Less developed	735	2,305	2,620	2,450	3,233	4,103	5,424
Communist	90	365	145	287	78	−188	−2
Eastern Europe	30	30	−70	57	14	−143	48
U.S.S.R	−5	20	−60	16	18	−27	−64
Other	65	310	275	214	49	−17	14

Source: Central Intelligence Agency's quarterly trade reports on China and the CIA's Handbook of Economic Statistics.

In contrast, the role of communist countries in China's trade picture has continued to diminish since 1978. As a share of total turnover, China's trade with communist countries fell to 10 percent in 1980 from 15 percent in 1978.[10] This trade in 1980 totalled $3.9 billion and, as was the case for most of the 1970s, was virtually in balance. Eastern Europe accounted for roughly two-thirds of the 1980 total and the U.S.S.R. about 12 percent. Romania remained China's leading communist trading partner with bilateral trade in 1980 totalling $1.1 billion. Petroleum and petroleum products have accounted for an increasing share of PRC exports. In 1980, China shipped to Romania an estimated 20,000 b/d of oil. (China also exports oil to North Korea and, prior to 1979, shipped petroleum to Vietnam. Because of Vietnam's military involvement in Kampuchea, Beijing severed relations with Hanoi in 1978.) Meanwhile, Romania's exports to the PRC largely consist of machinery and transport equipment. Fertilizers, rolled steel and tubes, and chemicals account for the remainder. In earlier years, Romania was the leading supplier of oil rigs to China.

In trade with the USSR, deliveries of fresh fruit and clothing were responsible for roughly one-half of China's exports in 1980 while Soviet trucks and aircraft and aircraft parts accounted for about three-fourths of PRC imports.

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[10] At the start of the decade, PRC trade with communist countries accounted for 21 percent of China's total trade.

This paper examines China's hard currency export potential and import capacity over the next four years in light of the retrenchment program and the economic problems facing the PRC. As in the past, China in deciding the level of imports presumably will try to balance its requirements with what it thinks it can afford. What it can afford—China's import capacity—largely is determined by hard currency earnings from the sale of goods and services; overseas remittances and other commercial earnings; the availability of Western credits and Beijing's willingness to utilize them; and the cost of servicing past debt. The paper also examines China's import needs during retrenchment and highlights what the PRC is expected to purchase from the West over the four years. The last section, meanwhile, discussed the prospects for U.S.-PRC trade in 1982–85.

II. ANALYTICAL APPROACH

China's hard currency export potential will be assessed by considering past export performance, the availability of goods, and future Western demand. While historical trade data alone may not necessarily be a good indicator of China's export prospects, meaningful export projections can be made by combining past data with the outlook for domestic production and consumption and Western demand. An indication of the latter can be obtained by considering China's bilateral trade agreements, protectionist sentiments in the West, and the outlook for Western economic growth.

To project PRC's exports to the West through 1985, China's exports are broken down into four major commodity categories and key export items under each category are examined.[11] Assumed nominal average annual rates of growth, which are based on the considerations discussed in the preceding paragraph, are used to project out through 1985 the level of exports of each major commodity category under a high and low scenario. In turn, China's import capacity—what the PRC can afford to buy in the West—under the two scenarios is calculated by summing earnings from projected hard currency exports and invisibles and capital inflows from direct foreign investment and drawings of Western credits, less debt servicing and additions to foreign reserves.

Data used in this paper are from Western sources. Aggregate commodity data on China's trade with the West and data for trade by country by commodity are derived from United Nations' (UN) foreign trade statistics, which are broken down to the 5-digit Standard International Trade Classification (SITC), Revision 1 level.[12] To date, the PRC has publicly released only aggregate figures for China's total imports and exports.[13] In addition, the import data reportedly do not reflect the total flow of merchandise goods into the PRC because deliveries stemming from compensation trade agreements are not included in the import figures.

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[11] The major categories are foodstuffs, crude materials, chemicals, and other manufactures.

[12] The aggregate commodity data are found in Central Intelligence Agency (CIA) publications *China: International Trade Second Quarter*, 1980 (ER CIT 81-001, February 1981) and *China: International Trade Quarterly Review Second Quarter, 1979* (ER CIT 80-001, January 1980). The CIA has adjusted Western imports from China to reflect Chinese exports on a F.O.B. basis. Data for PRC trade by country by commodity are from the OEWPP foreign trade data base. These data have not been adjusted to compensate for the reporting of imports on a C.I.F. basis, which is the valuation method used by most Western countries. OEWPP's East-West trade data base covers the trade of 33 Western countries with China; these countries account for roughly 85 percent of China's total trade with the West.

[13] China report imports C.I.F. and exports F.O.B.

III. EXPORT POTENTIAL

The growth of China's hard currency exports is expected to slow in 1982-85 largely because of Beijing's efforts to improve living standards, shortfalls in oil production, and growing Western protectionism. However, sales stemming from China's compensation trade agreements with Western firms should help bolster Chinese hard currency exports over the next four years. Under these compensation agreements, the Western partners are obligated to buy at least a portion of the finished output from the venture.[14]

During the first half of the 1980s, the sale of manufacturers—particularly textiles and other light industry goods—are expected to continue to be the driving force behind China's hard currency export growth, many of the PRC's compensation agreements involve the production of these goods. In the mid-1980s, foodstuffs could become a more important foreign exchange earner because of Beijing's new agricultural policies that are aimed at achieving greater efficiency and productivity.

The following is an assessment of China's export capabilities by major commodity categories for 1982-85

Foodstuffs.—Because of increasing domestic demand, it is unlikely that the growth of foodstuff exports will rise much above the 1977-80 average annual rate of 10 percent—at least in the early 1980s (see Table 2). These exports have steadily declined as a share of total PRC sales to the West and in 1980 accounted for about one-sixth of China's hard currency exports. Although the readjustment program calls for increased investment in agriculture, the immediate focus is on import substitution and boosting domestic consumption. Prospects are good, however, for substantial increases in exports of foodstuffs—particularly prepared fish and meat and tea—in the mid-1980s.

China recently launched a major program to modernize and expand its fishing fleet and processing capacity. In addition to expanding its own ship construction program, the PRC has made substantial purchases of foreign vessels and fishing equipment over the past few years. Beijing also signed several compensation trade agreements with Japanese companies that involve the purchase of Japanese fishing technology and equipment in exchange for the sale of Chinese marine products. China's hard currency fish exports, which reached an estimated $390 million in 1980, have accounted for a growing share of total foodstuff exports. The sale of higher quality fish largely has been responsible for the recent increase in the value of exports. Although China's Asian neighbors such as Hong Kong and Japan traditionally have been the PRC's chief customers, Western Europe and the U.S. offer potentially large markets.

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[14] Chinese compensation trade agreements generally call for the Western firm to supply the capital, technical assistance, and, in some cases, the raw materials or components at no charge while China provides the factories and labor. The Western partner then buys the finished good at a discount, which allows it to cover the cost of supplying the technology and components.

TABLE 2.—PRC FOODSTUFF EXPORTS TO THE WEST

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980[1]	Percent[2]
Total foodstuffs (SITC 0, 1)	1,715	1,740	1,650	1,655	2,005	2,355	3,100	10
Of which:								
Animals, meat, and fish (SITC 00, 01, 03)	505	570	640	575	740	855	1,030	13
Leading Western importers:								
Hong Kong	316	357	391	402	440	476	608	
Japan	100	80	90	83	163	217	221	
France	32	35	35	24	26	22	45	
Grains (SITC 041–045)	570	520	270	240	260	250	300	−10
Leading Western importers:								
Hong Kong	90	80	74	62	72	75	98	
Japan	13	20	16	11	87	5	9	
Indonesia	64	153	35	63	22	0	(4)	
Fruits and vegetables (SITC 05)	265	295	350	430	520	645	825	21
Leading Western importers:								
Hong Kong	96	107	114	136	167	187	215	
Japan	55	57	91	107	117	142	147	
Federal Republic of Germany	32	33	38	38	49	77	117	
Singapore	33	33	35	42	54	64	71	
Teas and spices (SITC 074, 075)	(3)	90	130	165	205	240	300	27
Leading Western importers:								
Hong Kong	8	10	13	18	22	28	29	
France	4	6	7	8	13	17	24	
Singapore	4	6	7	10	10	13	18	
United States	3	5	8	10	9	14	15	

[1] Commodity data are estimates.
[2] Average annual rate of growth for 1975–80.
[3] Not available.
[4] Negligible.

Source: Aggregate commodity data are from the CIA quarterly reports on China's foreign trade. Data for leading Western importers are from OEWPP's East-West trade data base. Since aggregate commodity data is f.o.b. and country data import is generally c.i.f., the sum of the country data in some cases may exceed the aggregate commodity data.

The readjustment program's emphasis on boosting livestock production—particularly hogs and chickens—coupled with planned improvements in meat preparation, storage, and transport should help generate additional exports toward the mid-1980s. The easing of restrictions on private ownership of livestock also is expected to contribute to higher output. The bulk of China's hard currency meat exports currently go to Hong Kong and Japan but this market should be expanded as the PRC's food processing capabilities improve. Meanwhile, China's hard currency sales on tea and spices are expected to continue at a strong pace. These exports have grown at an average annual rate of 27 percent since 1975. At the expense of more traditional suppliers, the PRC in recent years has made good inroads into the world tea market; China reportedly has won a reputation for reliability and comptetitive prices.

Crude Materials.—Unless there are hefty increases in world oil prices in 1982–85, the growth of China's crude material exports during this period is expected to be substantially lower than the 37 percent average annual increase registered in 1977–80 (see Table 3). Oil sales accounted for roughly two-thirds of the PRC's crude material export earnings in 1980. Because of declining oil production and growing domestic demand, the volume of China's oil exports can be expected to remain stagnant over the next four years at best. The volume of oil exports in 1980 fell by 5 percent.[15] Unfortunately for Beijing, onshore oil production has begun to decline and oil from offshore fields is not expected to begin flowing commercially before 1985 at the earliest. (At the outset of China's modernization drive, Beijing reportedly had hoped that oil would be a major source of the foreign exchange needed to finance the purchase of Western machinery and technology). According to Beijing, petroleum production in 1981 fell by 100,000 barrels/day and is expected to drop by 200,000 barrels/day in 1982.[16] China's oil output in 1980 totaled 2.0 million barrels per day.

TABLE 3.—PRC CRUDE MATERIAL EXPORTS TO THE WEST

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980 [1]	Percent [2]
Total crude materials (SITC 2, 3, 4)	1,140	1,585	1,495	1,715	2,175	3,440	5,300	29
Of which:								
Oilseeds (SITC 22)	125	135	80	70	80	170	170	5
Leading Western importers:								
Japan	77	86	54	48	43	117	81	
Hong Kong	7	7	11	8	8	12	20	
Federal Republic of Germany	6	5	3	4	4	9	9	
Textile fibers (SITC 26)	160	210	255	280	375	490	470	20
Leading Western importers:								
Japan	106	90	108	130	201	224	179	
Italy	27	42	56	67	78	149	119	
United Kingdom	22	14	21	24	30	40	54	
Crude animal materials (SITC 29)	160	195	240	295	330	385	500	21
Leading Western importers:								
Hong Kong	48	50	65	89	105	106	132	
Japan	31	26	35	44	50	80	83	
Federal Republic of Germany	38	41	48	52	56	58	72	
United States	10	8	24	31	41	32	57	
Coal (SITC 32)	(3)	15	15	20	40	85	90	43
Leading Western importers:								
Japan	13	17	12	20	37	69	117	
Federal Republic of Germany	0	0	0	0	1	6	12	
United Kingdom	0	0	0	0	0	3	4	
Petroleum (SITC 33)	450	815	705	855	1,075	1,890	3,500	41
Leading Western importers:								
Japan	419	748	580	665	782	1,119	2,259	
Hong Kong	26	56	63	105	161	290	450	
United States	(4)	0	0	(4)	(4)	105	151	

[1] Commodity data are estimates.

[2] Average annual rate of growth for 1975–80.

[3] Not available.

[4] Negligible.

Source: Aggregate commodity data are from the CIA quarterly reports on China's foreign trade. Data for leading Western importers are from OEWPP's East-West trade data-base. Since aggregate commodity data is f.o.b. and country data import is generally c.i.f., the sum of the country data in some cases may exceed the aggregate commodity data.

China already has informed Japan—the PRC's leading oil customer—that oil deliveries in 1982 will fall far short of the amounts pledged under the long-term trade agreement signed in 1979. Deliveries in 1981 totalled only 60 million barrels and the same level is expected in 1982. The agreement originally called for exports of 69 million and 110 million barrels, respectively.[17]

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[15] Chinese exports of crude oil and petroleum products in 1980 totaled 305,000 barrels/day.

[16] Wall Street Journal, Dec. 29, 1980, p. 12.

[17] Id.

Although Beijing is introducing more comprehensive and forward looking energy policies, rapid results are not expected. Project lead times and investment requirements, which are more massive than the Chinese are capable of making at this time, should hold down the growth of energy production through the mid-1980s. Growing domestic demand is expected to further limit the volume of oil exports despite China's recently launched conservation program and the push to use more coal and other alternative energy sources. While initial gains from conservation measures seem promising, similar gains cannot be repeated many years in a row. Furthermore, planned hydropower projects are not scheduled to come on line by 1985 and China apparently is having difficulty boosting coal output; coal production has been virtually stagnant since 1978.[18] The development of large new coal mines currently underway will not bear fruit until the mid- to late-1980s at best.

With the possible exception of coal, other important crude material exports—textile fibers and crude animal and vegetable materials—are expected to continue growing at roughly their 1975–80 pace. Exports of textile fibers rose at an estimated average annual rate of 20 percent while crude animal and vegetable material exports increased annually by roughly 21 percent. Since silk and animal hairs account for nearly all of China's hard currency textile fiber exports, sales of these goods should not be affected by rising protection sentiments in Western Europe against imports of synthetic fibers. The EC and Japan have been the leading importers of Chinese textile fibers and other crude materials—mainly bristles, feathers, plants, and seeds.

Meanwhile, the future of China's coal exports is less certain because of the problems facing the coal industry and the use of coal as the country's major source of primary energy. Under a long-term bilateral trade agreement, coal exports to Japan—China's leading customer—are scheduled by 1983 to reach 3.5 million tons, or two and a half times 1979 deliveries. However, China may have difficulty in meeting the target since Beijing already is struggling to halt the decline in coal production. Coal output in 1980 fell by 2.4 percent to 620 million tons and in 1981 declined to 617 million tons. In the near-term, coal production should continue to be hampered by transport bottlenecks, hard currency shortages, and poor management practices.

Chemicals.—Chinese exports of chemicals, which account for roughly seven percent of the PRC's total hard currency exports, should maintain their recent healthy pace—at least through the early 1980s (see Table 4). In 1975–80, chemical exports rose at an average annual rate of 23 percent. Organic compounds, pharmaceutical products, fireworks, and resins comprise the bulk of these exports. Hong Kong, the EC, and Japan have been China's main customers for chemcial products.

Manufactures.—Exports of manufactured goods, which account for about 45 percent of China's total hard currency merchandise sales, are expected to continue growing at a brisk pace over the next several years and then taper off. Since 1976, these exports have increased at an average annual rate of roughly 32 percent (see Table 5). Because of greater investment spending for light industry and an increasing number of compensation agreements involving the production of light industry goods, China's output of manufactures—particularly textiles products—presumably will continue to register substantial gains over the next several years. Growing protectionist sentiments in the West and rising consumer demand at home, however, are expected to dampen the growth of China's manufactured exports in the 1982-85 period.

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[18] China produced 617 million tons in 1981, 620 million tons in 1980, 625 million tons in 1979, and 618 million tons in 1978.

TABLE 4.—PRC CHEMICAL EXPORTS TO THE WEST

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980 [1]	Percent [2]
Total chemicals (SITC 5)	345	255	290	350	410	720	1,200	23
Of which:								
Organic chemicals (SITC 512)	48	48	48	46	73	155	270	33
Leading Western importers:								
Japan	7	6	6	7	11	42	65	
Hong Kong	5	6	8	8	14	24	35	
Federal Republic of Germany	5	7	4	4	5	11	27	
Inorganic chemicals (SITC 513)	15	16	14	9	15	23	60	26
Leading Western importers:								
Hong Kong	4	4	3	2	3	5	9	
United States	1	2	4	1	4	5	7	
Japan	1	1	1	1	1	3	10	
Other inorganic chemicals (514)	20	17	20	19	26	64	120	35
Leading Western importers:								
United States	(3)	(3)	(3)	5	1	15	27	
Japan	3	3	3	4	4	6	19	
Federal Republic of Germany	1	2	3	1	3	7	10	
Hong Kong	3	3	3	3	4	6	13	
Pharmaceutical products (SITC 54)	33	41	37	45	56	90	160	30
Leading Western importers:								
Hong Kong	15	22	19	23	25	37	48	
Singapore	4	5	5	7	8	11	12	
United States	1	2	1	1	3	5	11	
Japan	2	2	2	3	5	8	11	
Fireworks (SITC 57)	13	18	28	37	44	69	90	38
Leading Western importers								
Hong Kong	1	4	8	12	13	20	34	
United States	1	3	7	10	14	18	26	
Japan	6	4	6	6	6	15	11	

[1] Commodity data are estimates.

[2] Average annual rate of growth for 1975–80.

[3] Negligible.

Source: Aggregate commodity data are from the CIA quarterly reports on China's foreign trade. Data for leading Western importers are from OEWPP's East-West trade data bnase. Since aggregate commodity data is f.o.b. and country data is c.i.f., the sum of the country data in some cases may exceed the aggregate commodity data.

TABLE 5.—PRC MANUFACTURES EXPORTS TO THE WEST

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980 [1]	Percent [2]
Total manufactures (SITC 6, 7, 8)	2,020	2,185	2,535	2,990	3,880	5,450	7,850	25
Of which:								
Textile yarn, fabrics, rugs (SITC 65)	690	840	930	1,010	1,415	1,910	2,470	24

TABLE 5.—PRC MANUFACTURES EXPORTS TO THE WEST—Continued

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980 [1]	Percent [2]
Leading Western importers:								
Hong Kong	134	195	259	273	456	618	830	
Japan	100	113	120	124	221	313	295	
Singapore	43	63	57	56	84	92	118	
United States	28	33	47	36	67	68	149	
Clothing (SITC 84)	260	250	340	495	595	1,000	1,630	36
Leading Western importers:								
Hong Kong	44	43	70	102	132	217	457	
Japan	99	55	48	61	87	174	239	
United States	5	9	16	25	68	166	278	
Federal Republic of Germany	12	16	22	38	47	75	142	
Footwear (SITC 85)	(2)	30	40	60	90	130	190	45
Leading Western importers:								
Hong Kong	8	8	9	13	17	30	54	
Japan	2	2	2	3	4	8	15	
United States	(4)	1	3	3	4	17	22	
France	4	6	4	6	7	11	21	
Iron and steel (SITC 67)	150	60	80	63	100	150	230	7
Leading Western importers:								
Hong Kong	26	15	15	15	36	57	71	
Japan	(4)	0	2	(4)	0	(4)	36	
Pakistan	13	6	10	4	10	14	10	
Singapore	6	3	4	3	6	7	16	
Nonferrous metals (SITC 68)	65	90	55	35	75	80	130	12
Leading Western importers:								
United States	11	42	16	6	21	8	47	
Yugoslavia	1	2	6	14	23	20	14	
Japan	8	5	5	4	7	15	13	
Hong Kong	2	3	5	5	7	15	32	
Netherlands	11	8	7	4	9	13	8	
Nonmetallic mineral products (SITC 66)	(2)	130	150	180	250	300	400	25
Leading Western importers:								
Hong Kong	58	55	57	60	83	108	137	
Japan	10	8	11	14	22	29	40	
United States	2	3	4	5	5	7	21	
Singapore	16	15	11	9	12	13	17	
Metal products, industrial (SITC 69)	(2)	95	100	132	155	230	370	31
Leading Western importers:								
Hong Kong	16	17	23	27	33	53	94	
Singapore	16	14	16	16	16	17	27	
United States	(4)	1	1	1	6	12	24	
Federal Republic of Germany	1	(4)	1	3	5	7	16	
Indonesia	4	2	8	10	9	15	14	
Handicrafts and light manufactures (SITC 82, 83, 86, 89)	(3)	155	205	345	375	530	820	40
Leading Western importers:								
Hong Kong	50	58	81	95	115	189	329	
Japan	72	37	28	47	50	78	91	
United States	3	16	28	29	47	57	117	
Federal Republic of Germany	7	16	22	30	40	44	58	
France	13	14	17	23	26	36	47	

[1] Commodity data are estimates.
[2] Average annual rate of growth for 1976–80.
[3] Not available.
[4] Negligible.

Source: Aggregate commodity data are from the CIA quarterly reports on China's foreign trade. Data for leading Western importers are from OEWPP's East-West trade data base. Since aggregate commodity data is f.o.b. and country data import is generally c.i.f., the sum of the country data in some cases may exceed the aggregate commodity data.

Textile products, which now account for roughly one-half of China's manufactured exports and have been a driving force behind the recent surge in Chinese sales of manufactures to the West. (Hard currency earnings from textiles in 1979 reached a record $4.1 billion—triple the 1976 level.) However, the growth of these exports over the next four years should be constrained by Western import quotas. China in 1980 signed a bilateral textile agreement with the United States that levies annual quotas on six major categories of clothing and permits the U.S. to negotiate restrictions on other categories if these imports contribute to or threaten market disruption; the agreement runs through 1982. In addition, the PRC has signed a somewhat restrictive agreement with the European Economic Community (EC). Several other industrial countries, such as Canada and Sweden, also have imposed import quotas on Chinese textiles. Hong Kong, Japan, and the EC rank as the leading importers of Chinese textile products. In the past several years, the U.S. has become an important market for Chinese clothing.

The near-term outlook also appears promising for other Chinese manufactured exports such as basketworks and other nontextile light industry goods; metal products, especially nails, hand tools, and household utensils; and nonmetallic mineral products—mainly building materials. In recent years, China has achieved small but growing markets for these products. The emphasis Beijing has put on expanding the output of light industry and other sectors whose exports offer a quick payback with little investment should ensure strong export gains—at least in the near-term. Although China's Asian neighbors traditionally have been the PRC's main customers for these products, sales to Western Europe recently have increased sharply.

China's exports of nonferrous metals, on the other hand, are expected to continue growing at a slow pace at least through 1985. Although the PRC reportedly has large reserves of nonferrous metals, its inability to develop an export surplus has hindered sales to the West.[19] If China expects nonferrous metal exports to become an important source of hard currency earnings, it will have to open new mines and build the necessary infrastructure such as power stations and transport facilities. Chances of accomplishing this before 1985 are slim because of cutbacks in capital construction and energy shortfalls, however. Exports of nonferrous metals—mainly tungsten, tin, and antimony—have been erratic and in 1980 accounted for only an estimated 2 percent of China's total manufactured goods exports to the West.

IV. OTHER SOURCES OF HARD CURRENCY EARNINGS

A. Invisibles

Revenues from invisibles in 1982-85 are expected to continue rising and may accelerate as a result of China's determination to enlarge its merchant fleet, expand its overseas commercial ventures, and exploit the country's tourism potential. Major sources of nonmerchandise trade earnings include:

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[19] China is considered to have large deposits of nonferrous metals such as tungsten, antimony, manganese, mercury, molybdenum, copper, lead, zinc, and aluminum ores.

Transport.—Although a less rapid expansion of China's maritime industry is expected because of the readjustment program, continued efforts to further enlarge the PRC's merchant fleet coupled with the growth of China's trade should ensure a steady increase in transport earnings in 1982–85. China's fleet, which totals more than 11 million dwt, is now the 12th largest in the world and comparable in size to the fleets of Spain and West Germany.[20] China's purchases of Western ships, which include many second-hand vessels, reflect Beijing's aim to reduce chartering costs and save hard currency by carrying a higher percentage of China's trade—particularly its rapidly expanding bulk imports. China's fleet reportedly now carries about 70 percent of the PRC's seaborne foreign trade tonnage compared with less than one-quarter ten years ago. In the long-run, Beijing probably hopes to become more active in cross-trading in Southeast Asia—a market now dominated by Western shipping firms.

Remittances.—PRC plans reportedly call for annual remittances, which traditionally have been China's most important source of nonmerchandise trade income, to reach $1 billion by 1985 from an estimated $700 million in 1980. The 1985 target implies an average annual growth rate of roughly 7 percent—an increase that probably is attainable. Since 1977, the rate of growth of remittances has declined steadily. The substantial increase in overseas Chinese visitors and economic conditions in neighboring countries probable are responsible.

Tourism.—Hard currency earnings from tourism, which has become one of the most rapidly growing industries in China, should continue rising at a steady pace in 1982–85 and replace remittances as the leading source of non-merchandise income. In 1980, earnings from tourism totalled roughly $620 million—one-third higher than in 1979. Despite limited facilities, the PRC expects the number of tourists to increase about 30 percent a year and reach nearly 2 million in 1985; an estimated 530 thousand tourists visited China in 1980.[21] Beijing has stressed the development of the country's tourist industry because if offers quick returns without large investments. In addition, the industry can absorb large numbers of unskilled and semi-skilled workers. While Beijing has cancelled plans for the construction of several large hotels, it has proceeded with the construction of more economical medium and smaller hotels, and the expansion and renovation of larger older hotels.

Other Commercial Activities.—Income from PRC business ventures in Hong Kong should rise rapidly as a result of China's international economic expansion. In addition to its insurance companies, shipping agencies, retail outlets, and real estate holdings, Beijing since 1979 has organized eight new engineering and construction companies to work in other countries in an effort to earn additional foreign exchange. The flow of earnings back to China, however, will be tempered by the reinvestment of profits in China's Hong Kong holdings and partially offset by capital outflows from the PRC as foreign companies participating in joint ventures in China repatriate their profits.

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[20] China: International Trade Fourth Quarter, 1980 (National Foreign Assessment Center, ER CIT 81-003, May 1981).

[21] Beijing Review, No. 20, May 19, 1981, p. 18.

B. Foreign Capital Inflows

Direct foreign investment in China, at least through 1985, is likely to be only a marginal source of foreign exchange. Despite the flurry of excitement that surrounded the adoption of the PRC's joint venture law in July 1979, only about two dozen arrangements—representing an estimated $177 million in foreign capital—reportedly so far have received final approval from China's Foreign Investment Control Commission (FICC).[22] Western firms apparently are waiting for Beijing to publish additional regulations—particularly on tax and wage rates—before they make financial commitments; the gaps in China's legal structure make it difficult to evaluate risks and profitability of joint ventures. Even when these uncertainties are finally resolved, however, joint projects will be constrained by China's technical capabilities and its inadequate infrastructure.

In contrast with joint ventures, cooperative production arrangements and compensation trade should grow in importance over the next five years as source of foreign capital and equipment. In cooperative production, the foreign partner puts up 100 percent of the necessary capital, while Chinese provides the land and labor. Most of these ventures, which transfer to full Chinese ownership after 10-20 years, are small or medium in size; involve Hong Kong firms; and are located in Guangdong Province. In 1980, between $600 million and $700 million reportedly was invested by foreigners in cooperation production arrangements.

Under compensation trade, foreign partners are expected to supply the machinery and equipment, technical assistance, and in some cases, the raw materials or components at no charge while China provides the factories and labor.[23] The Western firm then buys the finished goods at a discount, which allows it to cover the cost of supplying the technology and components. In 1980, foreign firms involved in compensation trade reported provided equipment value at over $100 million.[24]

Because of the retrenchment program and China's traditionally conservative position on incurring debt, Beijing most likely will try to keep its trade with the West close to balance and to minimize its use of Western credits in 1982-85. However, the PRC will need foreign assistance to finance completely the huge planned investment projects—particularly in the hydropower, coal, and petroleum industries—since the country's capital resources are insufficient.

Medium- and Long-Term Credits.—The level of foreign borrowing for 1982-85 depends largely on the length of China's readjustment period, its export prospects, and, to a lesser extent, capital inflows from other sources. If the retrenchment period ends in 1985, Beijing could step up its foreign borrowing within the next several years. In any event, China is expected to turn first to soft loans from international financial institutions and development assistance credits such as those extended by Japan and Belgium to meet its financial needs. The PRC in 1981 received from the IMF for general balance-of-payments use a $550 million stand-by credit, a $380 million Trust Fund Loan, and an additional $190 million from its reserve tranche. Beijing also has received a $200 million World Bank loan for the improvement of science and technology education in China. This loan is a blend of International Development Association (IDA) funds, which carry only a small service charge, and International Bank for Reconstruction and Development (IBRD) funds.

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[22] Beijing Review, No. 16, April 20, 1981, p. 16.

[23] In compensation transactions involving other communist countries, credit generally is an integral part of the arrangement. Other communist countries in most cases use government-backed or commercial credit to purchase the necessary machinery and technology from the Western firm.

[24] Beijing Review, No. 16, April 20, 1981, p. 16.

Despite the availability of extensive foreign credits, Beijing has opted to hold down its foreign debt. The PRC so far has drawn down only about $2.0–$2.5 billion of the $29 billion in credits it has lined up in 1978–80.[25] China's traditional aversion toward indebtedness and the shift away from the importation of complete plants during the readjustment period largely are responsible for Beijing's cautious use of foreign credits. At yearend 1980, China's gross hard currency debt was only an estimated $3.5–$4.5 billion—roughly one-fourth of hard currency exports and easily manageable. The debt figure includes Euro-, officially-backed, and development assitance credits; a $280 million reserve tranche China received from the IMF in November 1980; deferred payments on whole-plant contracts that were signed in the mid-1970s; loans stemming from compensation trade with foreign firms; and short-term credit.

Beijing has expressed a clear preference for government-backed credits and, more recently, loans from international financial institutions because of their lower interest rates and longer repayment periods. Of the $29 billion in credits obtained in 1978–80, medium- and long-term officially-backed credits accounted for about two-thirds with nearly all of the remainder coming from commercial banks at interest rates usually reserved for only the best customers—a 0.5 percentage point margin over the London Interbank Official Rate (LIBOR). (Table 6 contains a breakdown of China's major lines of Western credits for 1978–80 (by country.) The PRC also received in 1978–80 about $510 million in development assistance loans—project tied credits—at interest rates ranging from 0 to 3 percent. In November 1980, China withdrew $280 from its reserve tranche at the IMF.

TABLE 6.—CHINA: LINES OF CREDIT, 1978–80

[Amounts in millions of U.S. dollars]

	Amount	Terms	Date signed
Major commercial credits (country of lead bank):			
United Kingdom	675	0.5 percent over LIBOR, 5-year repayment	April 1979.
Japan	2,000	0.5 percent of LIBOR, repayment after 4½ years	May 1979.
Do	6,000	0.25 percent over LIBOR, 6-month revolving credit	Do.
Canada	250	0.5 percent over LIBOR, repayment after 4½ years	1979.
West Germany	300	0.5 percent over LIBOR	1979

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[25] Some of the Eurodollar credits extended to China since 1978 reportedly have expired and are no longer available. In addition, the PRC also has cancelled some of its Eurodollar lines.

TABLE 6.—CHINA: LINES OF CREDIT, 1978–80—Continued

[Amounts in millions of U.S. dollars]

	Amount	Terms	Date signed
United States	95	Probably 0.5 percent over LIBOR, repayment after 3 years.	December 1979.
France	300	0.5 percent over LIBOR repayment after 3 years	February 1980.
Total	9,620		
Officially backed credits (lending country):			
United Kingdom	1,200	7.25 percent	December 1978.
Do.	5,000	7.2 to 7.5 percent	March 1979.
Australia	55	Not available	April 1979.
Japan	1,800	6.25 percent, up to 15 years, repayment	May 1979
France	7,300	7.25 to 7.5 percent, repayment after 5 plus years	Do.
Italy	1,000.	7.75 percent, repayment after 8½ years	Do.
Canada	1,720	7.25 to 7.5 percent, repayment after 5 years	Do.
Belgium	167	7.25 to 7.5 percent, repayment after 5 to 8 years	December 1979.
Norway	100	7.25 to 7.5 percent	January 1980.
Argentina	300	7.5 percent, up to 10 years repayment	June 1980.
Total	18,642		
Development assistance credits (lending country):			
Japan	210	3 to 3.25 percent, 10 years grace period followed by 30 year repayment period.	April 1980 (agreement reached in December 1979).
Do.	260	Same as above	October 1980.
Belgium	10	No interest, 10 year grace period followed by 30 year repayment period.	April 1980.
United Nations	30	Not available	Allocation for ½ of total made in reb. 1980.
Total	510		
International financial institution credits (lender): International Monetary Fund.	[1] 280	Reserve tranche	November 1980.

[1] SDR 218.1 million.

Short-Term Credit.—While short-term obligations probably will decline as a share of total debt, short-term borrowing is expected to continue playing a major role in financing imports of Western grain and meeting balance-of-payments needs. During the first half of 1980, China apparently reduced its use of short-term credits. Data from the Bank for International Settlement (BIS) show that Western commercial banks' gross claims of one year or less on China at the end of December 1980 totaled $924 million compared with $1,292 million at yearend 1979. These claims probably would have been somewhat lower but the PRC reportedly was forced to draw on short-term foreign commercial loans to help cover the estimated $300 million hard currency trade deficit registered the fourth quarter of 1980. At the end of the first half of 1981, China's short-term commercial borrowing was down about $200 million to $739 million.

V. IMPORT CAPACITY

Considering the above assessment, projected Chinese hard currency import capacity—what it can afford to buy in the West—in 1985 ranged from $27.8 billion to $36.2 billion. The projections are based on assumed high and low nominal average growth rates for each major export commodity group, net invisibles, and capital inflows. (See Table 7 for the projections and assumptions that were used to obtain them). Under the two scenarios, the implied average annual growth rates for China's hard currency import capacity for 1982–85 are 11 percent and 18 percent while the rates for exports are 9 percent and 17 percent.

TABLE 7.—PRC: HARD CURRENCY TRADE AND DEBT PROJECTIONS

[In billions of U.S. dollars]

	[1] 1981	1985		Assumed average annual rate of growth, 1982–85 (percent)	
		Low	High	Low	High
Total exports	20.9	29.2	39.0	[2] 9	[2] 17
Foodstuffs	3.7	5.4	7.7	10	20
Crude materials	6.5	7.3	9.1	3	10
Oil	3.8	3.8	5.0	0	7
Nonoil	2.7	3.5	4.6	7	14
Chemicals	1.3	1.8	2.3	8	15
Manufactures	9.3	14.5	19.2	12	20
Textiles	5.2	8.5	11.5	13	22
Nontextiles	4.1	6.0	7.7	10	17
Other	.1	.1	.2	10	20
Net invisibles (excludes interest payments)	.6	1.2	1.5	5	10
Direct investment	.3	.4	.4	5	10
M–L term credits [3]	1.5	3.0	4.5	19	32
Net short-term credits [4]	−.4	0	0		
Debt service [5]	1.9	2.3	2.9		
Addition to reserves [6]	2.5	3.7	6.3		
Import capacity	18.5	27.8	36.2	[7] 11	[7] 18
Gross debt [8]	4.7	9.8	14.1		
Debt service ratio [9] (percent)	9	8	7		

[1] Preliminary estimates for China's 1981 exports, earnings from invisibles, borrowing, debt servicing, and gross debt.

[2] The rate of growth for total exports for 1982–85 is a derived rate based on assumed growth rates for each major commodity categories.

[3] Medium- and long-term credits were assumed to be 7-year loans with a 3-year grace period at 8.0 percent interest. In addition to drawings from officially backed, multinational, and commercial loans, the credits also include borrowing stemming from cooperative production and compensation trade arrangements.

[4] Short-term borrowing in 1982–85 was held at the estimated 1981 level of $.7 billion. An interest rate of 15 percent was assumed.

[5] Includes principal and interest payments on medium- and long-term drawings and interest payments on short-term loans.

[6] Reserves are increased annually by the amount necessary to maintain the 1981 ratio of foreign reserves (excluding gold) to hard currency imports of roughly three-tenths.

[7] Growth rates were computed by using the estimated 1981 hard currency import of $17.1 billion.

[8] Includes outstanding short-, medium-, and long-term obligations.

[9] Computed by dividing principal and interest payments by the sum of merchandise exports and net invisibles.

In contrast with the assumptions used for exports under the high scenario, the low scenario assumes that China will suffer several poor harvests and experience greater difficulty in boosting fish output; oil production falls faster than expected, while coal output continues its downward slide despite Beijing's effort; and manufactures—particularly textiles—face more formidable Western trade barriers. The low scenario also assumes a slower rate of growth for China's other hard currency earnings and a lower level of borrowing from the West in 1982.

The projected slower growth through 1985 of China's hard currency exports and, in turn, its import capacity is expected to dampen the pace of PRC purchases in the West. Financial constraints on imports during the 1982–85 period are more likely to stem from inadequate export earnings and Chinese financial conservatism rather than from any lack of available credits. Although China in the past several years has demonstrated a willingness to finance purchases of Western goods with foreign credits, export earnings still are the most important factor in Beijing's assessment of what it thinks it can afford to buy.

Meanwhile, the retrenchment program, with its emphasis on agriculture, light industry, and improving living standards, should affect the composition of imports. The following is an assessment of China's imports for 1982–85.

Foodstuffs.—Barring unforeseen circumstances, Chinese imports of Western foodstuffs—roughly four-fifths of which is grain—are expected to increase but at a substantially slower pace than 53 percent average annual rate registered in 1977–80 (see Table 8). New livestock programs and the retention of a growing share of grain in the rural areas should continue to exert pressure on Beijing to boost grain purchases. (China imported roughly 13.6 million metric tons of grain from the West in 1980.) However, tighter world supplies and projected higher prices, should temper China's demand for Western grain over the next four years. As in the past, imports of wheat is expected to exceed corn purchases by a 3 to 1 margin; wheat and corn accounted for nearly all of China's grain imports.

TABLE 8.—PRC HARD CURRENCY IMPORTS

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980 [1]	Percent [2]
Total	6,410	6,385	4,905	5,531	8,770	12,540	17,355	18
Foodstuffs	1,275	785	470	935	1,205	1,665	2,600	13
Of which:								
Grain	1,180	670	325	655	965	1,430		
Sugar	(3)	65	115	245	155	105		
Crude materials	1,315	845	695	1,210	1,600	2,155	3,875	20
Of which:								
Oilseeds	130	15	5	115	35	115		
Crude rubber, natural	(3)	135	135	180	175	295		
Textile fibers, natural	(3)	260	190	360	695	995		
Textile fibers, synthetic	(3)	95	115	140	170	150		
Metal ores and scraps	(3)	(3)	(3)	55	110	115		
Petroleum and products		105	45	40	55	40		
Chemicals	525	760	490	740	960	1,185	1,700	22
Of which:								
Elements and compounds	(3)	(3)	205	270	350	380		
Fertilizers, manufactured	165	365	135	255	345	440		
Plastic materials	(3)	(3)	(3)	90	130	150		
Manufactures	3,255	3,960	3,225	2,630	4,960	7,430	9,010	18
Of which:								
Textile yarn and fabric	170	85	125	155	190	280		
Iron and steel	1,240	1,435	1,345	1,370	2,735	3,140		
Nonferrous metals	395	430	240	220	365	435		
Nonelectric machinery		900	905	250	580	1,695		
Electric machinery	1,240	180	185	60	160	465		
Transport		630	205	355	455	710		

See footnotes at end of table.

TABLE 8.—PRC HARD CURRENCY IMPORTS—Continued

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980[1]	Percent[2]
Precision instruments		40	45	35	65	130		
Other	40	35	25	30	40	105	170	21

[1] Estimate.
[2] Average annual rate of growth, 1975–80.
[3] Not available.

Source: Central Intelligence Agency.

China already has long-term agreements with several Western countries for the delivery of 12–17 million tons of grain annually over the next several years. In addition to the grain agreement with the U.S. that guarantees 6–9 million tons annually through 1984, China has accords with Canada for 2.8–3.5 million tons through July 1982; with Australia for 1.5–2.5 million tons annually through 1984; with Argentina for 1–1.5 million tons annually over the next four years; and with France for 0.5–0.7 million tons annually through 1983.

Sugar imports from the West in the early 1980s are expected to halt their recent decline and may even rise if world sugar prices continue to climb. Over the past several years, China has turned more to the West for sugar and away from Cuba—its traditional major supplier. The PRC recently signed a three year agreement with Australia for the delivery of 250,000 tons of sugar annually beginning in 1981; Australia, Thailand, and France are China's leading Western suppliers. Beijing reportedly also has agreed to import one million tons of sugar over the next seven years from the Philippines.

Crude Materials.—Largely because of the importance placed on boosting textile output by the readjustment program, PRC imports of crude materials from the West in 1982–85 are expected to continue increasing at a strong but somewhat slower pace. Imports of textile fibers, which now account for over half of the PRC's crude material imports from the West, have soared because China's cotton production has failed to keep pace with sharply rising demand; cotton accounts for the bulk of natural fiber imports with the remainder mainly wool. By a wide margin, the U.S. over the past three years has ranked as China's leading supplier of cotton.

Chinese imports of synthetic fibers also probably will increase in the 1980s because of Beijing's efforts to boost textile production and rising world cotton prices. In addition, expected shortfalls in oil output could hold down domestic production of synthetic fibers despite China's purchases of a substantial number of Western chemical fiber plants over the past ten years. Future production also should be limited by the recent postponement of several major petrochemical projects. The U.S. and Japan have been China's chief sources of synthetic fibers.

Soybeans imports are expected to continue climbing in 1982–85 largely because of rising domestic demand. Import growth, however, should be constrained by China's limited processing capability. Because of inadequate transportation, China has favored an inefficient system consisting of small, locally-controlled processing facilities. The U.S. since 1978 has supplied virtually all of China's soybean imports.

Chemicals.—Because of the high priority put on agriculture and light industry by the readjustment program, China's hard currency chemical imports should continue their recent upward trend. China's fertilizer output, which has risen sharply over the past several years, is expected to achieve only a marginal increase in the 1980s unless new capacity is added. The one-half billion dollars worth of fertilizer plants purchased from Japan, the U.S., France, and the Netherlands in the mid-1970s now are operational at close to full capacity. Consequently, any substantial boost in fertilizer imputs to China's agricultural sector in the early 1980s must come from imports. Japan and the EC have been the PRC's leading Western source of manufactured fertilizers, which acount for roughly one-third of China's total chemical imports from the West.

China's drive to boost textile output should ensure the continued increase of plastic material imports in the 1982–85 period. Synthetic resins, which are used in production of synthetic fibers, account for a large share of these imports. Japan, the EC, and the U.S. have been China's major suppliers of plastic materials.

PRC imports of chemical elements, on the other hand, are expected to level off over the next four years. These imports account for about one-third of China's total chemical purchases from the West. The slower growth should stem in part from the weakened demand for inputs that go into the manufacturing of fertilizer as the industry nears full capacity. Japan has been China's leading supplier with the U.S. a distant second.

Manufactures.—Reflecting the lower priority given to heavy industry during the retrenchment period and the sharp reduction in whole-plant purchases, the growth of hard currency manufactures imports—particularly steel and machinery—should slacken substantially in the early 1980s. Absorption problems coupled with the winding down of deliveries of Western machinery and equipment contracted for during China's 1978 buying spree also are expected to contribute to the slower pace.

Meanwhile, iron and steel purchases were slashed in 1980 and are expected to remain depressed at least over the next several years as Beijing tries to hold down capital construction. In 1976–79, iron and steel imports accounted for between 40 percent and 55 percent of PRC manufactured imports from the West. In 1980, however, they comprised only one-fourth of manufactured imports.

China will need substantial amounts of Western equipment and technlogy when it begins to develop its offshore oil. Western equipment also will be required to carry out plans for boosting oil output from its onshore fields and expanding existing coal mines. In addition, Beijing is actively seeking Western help for several massive hydroelectric projects. Chinese imports of Western mining and construction equipment have risen sharply since 1976 and totalled an estimated $300 million in 1980. West Germany, Japan, and the U.S. have been the chief suppliers of this type of equipment. (Data on imports of Western oil equipment is unavailable since UN trade data does not specifically break out this equipment.)

Meanwhile, Beijing is expected to continue efforts to overcome transportation bottlenecks and expand the size of China's merchant and fishing fleets. Transport equipment accounted for roughly one-quarter of China's imports of Western machinery in 1979. Imports of motor vehicles—largely trucks—increased by more than fivefold in 1976–79 while the value of Western ship and boat deliveries registered a similar sharp rise; vehicles and vessels account for virtually all of China's transport purchases. Over the past three years, the PRC has succeeded in doubling the size of its fleet to more than 10 million DWT and is expected to double it again by the end of the decade. Japan and the EC has been China's major supplier of transport equipment.

Imports of textile yarn and fabric and nonferrous metals should rise in 1982–85 but at a slower rate. The demand for Western textile yarn and fabric is expected to soften as China boosts textile production during the retrenchment period. Meanwhile, the shift away from heavy industry should dampen demand for nonferrous metal imports. Japan traditionally has been the PRC's chief source of textile yarn and fabric while Canada, Australia, and the EC have accounted for the bulk of China's nonferrous metal imports.

VI. OUTLOOK FOR U.S.-PRC TRADE

U.S. trade with China over the next four years is expected to grow at a substantially lower pace than that achieved since 1976. Because the major legal impediments to bilateral trade already have been overcome, the successful resolution of any remaining obstacles, while improving the commercial climate, will have only a marginal impact on the level of trade. More importantly, the combination of hard currency shortages, the extension of the readjustment program, and the country's inability to absorb further substantial increases in imports should dampen China's demand for U.S. products in 1982–85. (See Table 9 for U.S. exports to the PRC for 1974–80.)

Agricultural commodities are expected to continue to account for over one-half of U.S. total sales to the PRC over the next five years. Barring severe shortfalls in China's agricultural output, the volume of U.S. grain exports, to the PRC should level off in 1982–85 because of hard currency shortages and the closing of the gap between domestic requirements and production. The U.S.-PRC grain agreement, which will eliminate the wide fluctuations that characterized U.S. grain exports in the 1970s, guarantees annual U.S. sales through 1984 of at least 6 million tons of grain—15 to 20 percent of which must be corn. The agreement insures that the U.S. will maintain its current role as China's leading foreign supplier of grain.

TABLE 9.—U.S. EXPORTS TO THE PRC

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980	Percent [1]
Total export	806.9	303.6	135.4	171.6	319.2	1,716.5	3,749.0	28
Foodstuffs (SITC 0,1)	332.4	([2])	([2])	([2])	362.3	488.4	1,265.0	25
Wheat	234.0	0	0	0	250.2	214.1	1,039.3	....
Corn	95.7	0	0	0	111.7	268.5	224.5	....
Other	2.7	([2])	([2])	([2])	.4	5.8	1.2	....

TABLE 9.—U.S. EXPORTS TO THE PRC—Continued

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978	1979	1980	Percent [1]
Crude materials SITC 2, 3, 4)	325.3	100.3	13.1	84.4	261.3	574.3	1,258.4	25
Soybeans	126.5	(2)	0	14.4	15.3	106.7	155.2	....
Cotton	185.9	79.7	0	17.5	157.3	357.0	701.3	....
Synthetic fibers	1.6	2.0	7.5	19.0	46.4	62.2	193.9	....
Soybean oil	0	0	0	28.3	26.1	35.9	56.5	....
Pulp and waste paper	.1	5.0	1.3	1.3	4.1	3.9	66.9	....
Rough wood	0	0	0	0	0	0	41.4	....
Other	21.7	13.6	4.3	4.0	12.6	8.6	43.2	....
Chemicals (SITC 5)	10.1	5.3	10.4	20.0	60.5	125.9	383.0	83
Chemical elements	7.9	2.4	4.7	7.7	10.7	27.3	61.9	....
Manufactured fertilizers	0	0	0	8.1	38.7	44.6	152.6	....
Plastic materials	2.2	(2)	1.7	1.7	2.0	31.1	119.5	....
Insecticides	0	.3	0	0	5.7	11.6	28.4	....
Other	(2)	2.6	4.0	2.5	3.4	11.3	20.6	....
Basic manufactures (SITC 6)	18.6	73.8	43.3	10.8	25.3	244.1	427.8	69
Leather	0	0	(2)	0	(2)	3.9	49.1	....
Synthetic yarn	.4	0	0	.5	1.3	27.8	62.6	....
Woven synthetic fabrics	0	0	0	(2)	.1	5.7	54.7	....
Iron and steel tubes and pipes	2.6	12.0	10.9	.4	.5	150.4	8.0	....
Iron and steel wire rod	0	0	0	0	.2	.1	28.7	....
Copper	0	(2)	.1	(2)	4.5	6.5	.2	....
Magnesium, beryllium	0	0	0	0	1.7	8.3	8.7	....
Aluminum	(2)	46.8	26.3	5.3	(2)	1.9	15.2	....
Insert parts for hand tools	3.8	.6	(2)	.9	13.5	18.1	28.5	....
Paper and paperboard	7.1	1.4	(2)	3.4	.4	3.4	130.4	....
Other	4.7	13.0	5.8	.3	3.0	18.0	41.7	....
Machinery and transport equipment (SITC 7)	106.3	118.8	65.1	51.9	102.4	268.0	395.6	25
Power generating equipment	20.7	24.2	22.0	6.3	11.2	3.0	12.9	....
Office machinery	.1	.2	.4	1.9	1.1	10.8	30.6	....
Metalworking machinery	0	4.7	3.1	3.5	6.7	10.3	6.9	....
Construction and mining equipment	3.9	13.0	2.3	1.4	33.5	91.4	42.4	....
Heating and cooling equipment	6.4	26.6	8.4	.3	.8	.5	4.3	....
Pumps and centrifuges	7.8	26.6	11.5	1.4	7.3	9.6	18.8	....
Telecommunication apparatus	2.7	.5	.4	.7	1.1	6.2	7.4	....
Medical apparatus	.1	(2)	0	.1	.4	3.8	5.9	....
Electrical measuring and control equipment	3.2	4.5	.9	1.5	10.2	41.8	39.3	....
Road motor vehicles	.3	4.5	5.4	29.5	11.2	45.4	16.5	....
Aircraft	60.1	2.5	.5	.3	.4	7.7	155.1	....
Ships and boats	0	2	(2)	0	.7	5.0	8.1	....
Other	1.5	11.3	10.2	5.0	17.8	32.5	46.8	....
Miscellaneous manufactured goods (SITC 8)	2.7	5.0	3.4	4.5	4.2	15.2	17.0	34
Professional and scientific instrument	2.2	2.1	1.8	3.7	2.3	8.8	8.7	....
Other	.5	2.9	1.6	.8	1.9	6.9	8.3	....
Other	.5	.4	.1	.1	2.7	.6	2.2	27

[1] Average annual rate of growth, 1975–80.
[2] Negligible.

Source: UN peace tapes for 1974–80 data.

Hard currency shortages, rising world prices, and slower growth of world demand for textiles, meanwhile, are expected to slow China's rapidly growing demand for foreign cotton. Because of the PRC's limited processing capability, U.S. exports of soybeans to China in 1982–85 are expected to level off. However, the PRC may increase its purchases of U.S. soybean oil to meet growing domestic demand. China over the past several years has looked to the U.S. to satisfy the bulk of its soybean import needs and the U.S. now supplies over one-half of China's soybean oil import requirements.

U.S. manufactured exports to China in 1982-85, meanwhile, are expected to continue rising but at a pace well below the average annual rate of 78 percent registered since 1976. The general cutback in China's imports of Western machinery stemming from the retrenchment program, should reduce substantially the growth of U.S. equipment exports to the PRC over the next four years. Beijing will continue to be highly selective in its purchases of Western technology. Unless the U.S. has a clear technological advantage such as in the case of some oil equipment, computers, and electrical measuring and control equipment, China most likely will buy from countries that offer better financing.

Because of growing Chinese demand for intermediate goods needed for light industry, U.S. exports of basic manufactures, mainly synthetic fabrics, tire fabric, paper products, and leather, should continue to register strong gains in 1982-85. U.S. exports of steel tubes and pipes, however, are expected to retain at a low level until Beijing's effort to develop China's offshore oil fields and expand existing onshore facilities are in full swing.

U.S. chemical exports to the PRC should continue their upward trend in 1982-85 but at a slower pace because of China's foreign exchange constraints. With little additional production capacity expected over the next four years, Chinese demand for manufactured fertilizer should remain strong. China's efforts to increase agricultural output also should ensure continued strong demand for U.S. pesticides and herbicides. Because of emphasis placed on boosting Chinese textile output, U.S. exports to the PRC of plastic materials—mainly polyester resins—are expected to continue increasing at a healthy albeit slower pace.

The growth of China's exports to the U.S., meanwhile, will be hindered by the limited range of goods the PRC has to offer. (See Table 10 for U.S. imports from China for 1974-80.) Increases in Chinese exports of textile goods, which currently account for roughly 30 percent of the PRC's total exports to the U.S. will be restricted to some extent at least through 1982 by the U.S.-PRC Textile Agreement. In addition to limiting the growth of major Chinese apparel exports to the U.S., such as cotton knit blouses, cotton shirts and trousers and synthetic fiber sweaters, the textile accord includes a mechanism for the levying of import quotas on other textile products. When the current agreement expires, the U.S. most likely will seek a new bilateral accord that limits imports of Chinese clothing or will impose unilateral restrictions if an agreement cannot be reached. U.S. apparel imports from China in 1980, the first year of the bilateral accord, rose by about $100 million to roughly $250 million.

TABLE 10.—U.S. IMPORTS FROM THE PRC

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978 [1]	1979 [1]	1980 [1]	Percent [2]
Total imports	114.7	158.3	201.9	202.7	356.2	653.3	1,161.1	47
Foodstuffs (SITC 0, 1)	16.3	16.1	24.2	26.0	29.9	58.0	67.0	27
Fish	7.1	3.9	7.1	2.7	2.4	18.1	6.9	
Fruit and vegetables	2.0	2.8	5.7	8.7	11.5	12.6	27.7	

TABLE 10.—U.S. IMPORTS FROM THE PRC—Continued

[In millions of U.S. dollars]

	1974	1975	1976	1977	1978[1]	1979[1]	1980[1]	Percent[2]
Tea	1.0	2.0	2.9	5.2	5.5	9.1	11.9	....
Spices	1.9	3.0	4.9	4.6	3.4	4.8	3.3	....
Honey	.3	.2	.2	.2	.3	7.3	7.4	....
Other	4.0	4.2	3.4	4.6	6.8	6.1	9.8	....
Crude materials (SITC 2, 3, 4)	16.8	19.5	40.9	45.2	65.0	182.0	302.3	62
Silk	2.7	3.0	4.0	2.3	4.8	7.2	5.0	....
Fine animal hair (excluding wool)	1.3	.7	3.2	4.1	4.1	4.1	4.4	....
Natural barium sulphate and carbonate	0	0	0	0	2.0	12.3	33.5	....
Bauxite and concentrates of aluminum	(4)	.4	.9	0	0	3.1	13.8	....
Ores and concentrates of tungsten	1.1	2.2	2.3	4.3	6.0	9.5	16.6	....
Other ores and concentrates of nonferrous base metals	0	.1	.2	.4	.6	2.3	.6	....
Bristles	5.9	3.3	8.1	8.7	7.5	10.0	9.8	....
Bird feathers	2.1	3.0	14.2	19.0	26.1	10.1	26.1	....
Plants, seeds and flowers	.9	.6	1.4	1.7	3.3	8.6	14.1	....
Crude petroleum	0	0	0	0	0	77.0	20.1	....
Petroleum products	.1	0	0	(4)	(4)	27.7	131.1	....
Other	2.7	6.2	6.6	4.7	10.6	10.1	27.2	....
Chemicals (SITC 5)	18.4	15.9	18.0	21.8	38.5	65.7	114.8	36
Cyclic alcohols and derivatives	0	0	0	0	3.4	7.7	8.0	....
Salts of metallic acids	0	0	0	0	.2	13.9	25.1	....
Oxides and halogen salts	.8	1.9	3.9	1.3	3.7	5.0	7.0	....
Organic-inorganic heterocyclic compounds	0	0	0	0	.4	1.0	3.9	....
Medical products	1.0	2.1	.8	1.1	2.5	4.7	11.4	....
Essential oils	4.8	2.5	3.6	5.5	7.1	6.2	14.8	....
Fireworks	1.0	3.5	6.6	10.0	13.9	17.7	25.8	....
Gelatin and derivatives	1.2	.4	1.1	1.1	4.1	2.1	3.3	....
Wood resin	8.2	4.2	.6	1.4	1.6	4.8	4.3	....
Other	1.4	1.3	1.4	1.4	1.6	2.6	11.2	....
Basic manufactures (SITC 6)	42.7	79.4	68.3	49.6	101.6	100.6	249.7	34
Woven cotton fabric	25.6	27.4	33.2	17.5	40.3	25.8	47.2	....
Woven silk fabric	.1	.2	.6	1.1	1.6	2.3	7.0	....
Hat bodies	.8	1.8	2.3	2.0	2.8	4.4	10.6	....
Linens	.3	1.5	3.5	4.6	5.4	9.3	24.6	....
Carpets	.7	.9	4.4	7.4	10.9	18.0	40.7	....
Mats, screens, etc	.4	.7	1.9	2.3	4.1	6.0	12.5	....
Pottery	.8	1.0	1.8	2.8	3.3	4.1	16.0	....
Tin alloys	9.4	39.8	13.2	4.3	15.7	2.7	14.1	....
Base metals, m.e.s.	2.0	1.5	.8	1.1	4.5	5.3	31.9	....
Steel nails, spikes, etc	(3)	.1	.1	.1	3.9	9.9	14.4	....
Metal household utensils	.2	.2	.2	.3	1.4	1.3	3.5	....
Other	2.4	4.3	6.3	6.1	7.2	12.1	27.2	....
Machinery and transport equipment. (SITC 7)	.1	.3	1.3	.5	.5	1.2	6.2	9.9
Nonelectrical machinery	(3)	.1	1.0	.4	.3	.8	3.9	....
Electrical machinery	(3)	.1	.3	.1	.2	.4	2.3	....
Transport equipment	.1	.1	(3)	(3)	0	(3)	(4)	....
Miscellaneous manufactured goods (SITC 8)	19.2	25.6	47.5	58.0	120.2	240.2	417.6	67
Furniture	.3	.5	1.3	1.9	3.8	3.9	9.6	....
Clothing	5.5	8.8	16.5	25.5	68.5	165.8	278.0	....
Leather footwear	.4	1.1	3.2	3.3	3.8	16.2	20.1	....
Articles of plastics, m.e.s.	.5	.4	.4	.5	1.4	2.5	.7	....
Toys, games and sporting goods	.5	.2	.4	.6	.7	1.0	2.8	....
Art and antiques	7.8	6.0	11.6	9.0	12.8	16.5	39.1	....
Jewelry	.3	.7	1.0	1.1	1.7	1.6	6.9	....
Basketwork	2.6	5.3	10.1	10.7	20.3	26.4	43.0	....
Feather goods, n.e.s.	(3)	.1	.7	2.6	3.5	1.2	3.1	....
Other	1.3	2.0	2.3	2.3	3.7	5.1	14.3	....
Other	1.2	1.5	1.7	1.6	1.0	4.7	3.5	20

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[1] Data for 1978, 1979, and 1980 are C.I.F.
[2] Average annual rate of growth, 1975–80.
[3] Negligible.

Sources: UN Trade tapes, for 1974–80 data.

Growing sensitivity also could limit the gains of other Chinese exports in the 1982–85 period. Although small in comparison to U.S. footwear imports from other countries such as South Korea and Taiwan, the sudden surge in Chinese footwear sales to the U.S. has invoked complaints from U.S. shoe manufacturers. Chinese exports of prepared foods to the U.S. may run into similar problems. Because of an outcry from domestic producers, the U.S. in 1980 raised the import tariff on Chinese canned mushrooms.

Supply constraints are expected to hold down PRC sales of fuels and other raw materials to the U.S. in 1982–85. Because of the expected decline in China's oil production, the volume of exports to the U.S. most likely will fall. Petroleum deliveries were largely responsible for the recent jump in U.S. crude material imports from China and were a major contributor to the rapid growth of U.S. total imports from the PRC.

The outlook for substantial increases in exports of other crude materials, such as nonferrous metals, also appears slim, at least over the next four years. Because of production limitations, Chinese exports of nonferrous metal to the U.S. are not expected to play a major role in U.S.-PRC trade in 1982–85. Several projects that were designed to help boost China's nonferrous metal output reportedly have been postponed or cancelled.

SINO-JAPANESE ECONOMIC RELATIONS

By Richard K. Nanto*

INTRODUCTION

In 1951, Japanese Prime Minister Yoshida wrote to John Foster Dulles that the Japanese Government desired "ultimately to have a full measure of political peace and commercial intercourse with China." [1] During the ensuing two decades, however, Japan's ruling Liberal Democratic Party generally followed the U.S. lead and restricted most of its political and economic relations to Taiwan. The exchanges that did occur with the People's Republic were confined primarily to limited commercial trade and people-to-people diplomacy, often spearheaded by Japan's opposition political parties.[2] In 1965, however, despite these encumbrances, Japan became the PRC's major trading partner.

As the 1970s began, however, pressures were building around the Pacific Basin for a complete Sino-Japanese rapprochement. With the end of the Vietnam War combined with what China perceived to be an increased military threat from the Soviet Union and a need for new trade and diplomatic thrusts, China sought to improve its relations with Japan (and the United States).

Even before the announcement in 1971 of the thaw in American-Chinese relations, unofficial exchanges between China and Japan had been expanding. During 1971 and 1972, a remarkable reversal of consensus occurred in Japan that led to a normalization of relations with the People's Republic in 1972.

Japan now stands as China's leading trade partner with about 20 percent of its total exports and imports. The two economies share a natural complementarity buttressed by differences in level of development, wage levels, capital stock, and natural resource endowment. This complementarity provides for large gains to be made from specialization and exchange. Japan's high level of technological development, mechanization, and wage levels combined with a near absence of natural resources contrast sharply with China's lower levels of manufacturing technology, wages, nascent mechanization, as well as abundant reserves of natural resources (although somewhat underdeveloped).

The geographical proximity of China and Japan allows for inexpensive ocean transport compared with trading routes to Europe, the Americas, or Australia. In a statement accompanying the Sino-

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[1] Letter. Prime Minister Shigeru Yoshida to John Foster Dulles. Department of State Bulletin, Jan. 28, 1952. p. 120.

[2] For more information on Japanese-PRC relations during this period, see Chae-Jin Lee, Japan Faces China, Political and Economic Relations in the Postwar Era. Baltimore, Johns Hopkins University Press, 1976.

Japanese Treaty of Peace and Friendship, China referred to the two countries as being "joined by a strip of water".[3]

Sino-Japanese commercial relations also feed off of the deterioration in Sino-Soviet relations. Since China uses its foreign trade as an important instrument of foreign policy, it apparently has directed some trade toward Japan (and the United States) in an attempt to strengthen its position vis-à-vis the Soviet Union.

Prior to 1972, Sino-Japanese trade never exceeded $900 million both ways. In 1972, the two-way trade jumped to $1.1 billion, tripled to $3.3 billion in 1974, peaked at $3.8 billion in 1975 before dropping to $3.0 billion in 1976. By 1978, however, the two-way trade level had leaped to $5.0 billion, grew further to $6.5 billion in 1979, and reached $9.4 billion in 1980. In 1980, Japan bought 20 percent of the PRC's exports and provided 25 percent of its imports.

This bilateral trading relationship affects the United States in several ways. First, American and Japanese export industries compete directly with each other for sales of specific commodities in the China market. Second, the United States and Japan also compete indirectly in their levels of trade with the PRC. Since the PRC tends to incur trade deficits with both countries, a large deficit with one country will tend to depress purchases from the other. Third, solutions to problems Japan has encountered in its China trade can provide valuable information to guide U.S. actions in similar circumstances. And fourth, the United States has an interest in the development of friendly Sino-Japanese relations as a stabilizing force in Asia.

In this paper, Sino-Japanese economic relations are examined from a Japanese perspective in terms of institutions, cultural, and historical factors underlying trade and then in terms of the levels and commodity composition of that trade. Specific bilateral trade issues, including the problem of contract cancellations, are then discussed.

CHINA'S ORIENTATION TOWARD JAPAN: A NATURAL POSTURE?

Over the centuries, Japan has absorbed so much Chinese culture that the study of Chinese history, calligraphy, and literature is mandatory in Japanese public education. Until the nineteenth century, China was the center of the oriental world. Along with Korea, Japan's ethnic ties to China are probably closer than to any other nation.

China also views Japan as more of a kindred country than the nations of the West. In Chinese rhetoric, the Japanese might be classified with "monopoly capitalists", but unlike Westerners they are not tagged as "foreign devils". Japan's experience with economic development also serves as a model for China. China's four modernizations by which it plans to develop during the last two decades of the twentieth century is reminiscent of Japan's thrust for "fukoku kyohei" (rich nation, strong military) during the late nineteenth century.

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[3] Let the People of China and Japan Remain Friends for all Generations to Come, Renmin Ribao editorial reprinted in Beijing Review, Aug. 18, 1978. p. 10.

In modern times, however, relations between China and Japan have been more antipathetic than amicable. Beginning with the Sino-Japanese War in 1895, through Japan's establishment of Manchuria, peaking with Japan's invasion and occupation of much of China during World War II, and continuing with Japan's support of the U.S. policy of containment of China after 1949, Sino-Japanese relations in the twentieth century have been considerably less than friendly.

Although China has chosen not to make an issue of Japan's actions against it during World War II, among the Chinese people there is an undercurrent of resentment toward Japan that has been nurtured by decades of Chinese education and which could surface under certain circumstances. During the normalization talks between Premier Zhou and Prime Minister Tanaka, for example, the Chinese officials appeared to be visibly disturbed that Tanaka did not openly apologize for Japan's past actions against the Chinese people.[4]

China and Japan also differ considerably from each other. Westerners might be hard pressed to distinguish between the two races or their written languages, but there is probably almost as much difference between China and Japan as there is between the United States and Japan. Part of the gap between China and Japan stems from the divergent paths of economic development each has taken from the middle of the nineteenth century. While the two countries were economically similar in the mid-1800's, the rapid industrialization, modernization, Westernization, and the market oriented economy of Japan has catapulted its society more into a Western than Eastern mold. The typical citizen of Tokyo probably lives more like his counterpart in Washington than in Beijing.

Still, geographic proximity, long historical ties, close ethnic identification, the opportunity for mutually advantageous trade, the Chinese-perceived threat from the Soviet Union, and the sheer size of each economy compel closer economic ties between the two countries during the 1980s. These ties have been flourishing under the new institutional framework for Sino-Japanese economic relations developed during the 1970s.

TREATIES AND AGREEMENTS: THE TIES THAT BIND

Since the major portion of Chinese trade is conducted by government agencies, trade with the PRC has difficulty developing without an official institutional framework. In 1971, former President Nixon's announcement of his proposed visit to China came as a great "shokku" (shock) to Japan, in part because the ruling Liberal Democratic Party (LDP) had been resisting pressures from both the opposition Socialists and Communists and even factions within its own party to re-establish complete economic and diplomatic relations with China.

The Nixon announcement came with what many in Japan consider inadequate consultation with them. Japan most likely would not have opposed such a move anyway, but the growing Sino-

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[4] Lee, op. cit, p. 122.

American rapprochement left the LDP clinging to an obsolete foreign policy that potentially could have weakened its domestic political power.

Following the Nixon breakthrough, Japan's LDP moved quickly to upgrade Japan's ties with the PRC. Normalization of relations in 1972 was followed by a trade agreement in 1974 which included the mutual extension of most-favored-nation status. In 1978, the two countries concluded a Long-term Trade Agreement, a Treaty of Peace and Friendship, and extended the newly signed trade agreement. In addition, smaller agreements on aviation, maritime transport and cargo, and recognition of trade marks have also been signed.[5]

The Long-term Trade Agreement.—The Sino-Japanese Long-term Trade Agreement (LTTA), signed on February 16, 1978 had been under consideration for several years. The Agreement sets forth planned increases in imports from and exports to Japan.[6]

The agreement, itself, was signed by two private committees, although each had the support of its respective government. On the Japanese side the Provisional Committee for the Japan-China Long-term Trade Agreement consisted mainly of representatives from large Japanese corporations with interest in doing business with China, such as Nippon Steel, Mitsubishi Heavy Industries, and the Bank of Tokyo. On the Chinese side was the China-Japan Long-term Trade Council, headed by China's Vice-minister of Foreign Trade.

The eight-year agreement set specific targets for both the level of trade and for Chinese exports of crude oil, coking, coal and ordinary coal over the first five years of the agreement. It called for a total of $20 billion in two-way trade divided equally between the two countries.

According to the agreement, Chinese exports of crude oil to Japan were scheduled to rise from 7 million tons in 1978 to 15 million tons in 1982. Exports of coking coal were likewise slated to rise to 2 million tons in 1982 while ordinary coal was to increase to about 1.6 million tons. Japan was to export machinery and equipment to China. The equipment for phase one of the Baoshan Iron and Steel Works in Shanghai were the first complete plants imported from Japan under the agreement.[7]

Article 3 of the LTTA allows for China's imports to be financed on a "deferred payment formula," but no system of trade accounts, a type of barter system common among communist bloc nations, was established. The concept behind the agreement, however, was that China would trade its energy resources for Japan's high technology equipment and products. No specific interest rates or payment terms were designated in the agreement (mainly because the two sides could not reach a consensus on them). This problem was later solved in the extension of the LTTA.

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[5] In Japan, the three trade associations that deal with China are the Association for the Promotion of International Trade (Kobubosoko), the Japan-China Association on Economy and Trade (Nichu Keizai Kyokai) and the Japan External Trade Organization (JETRO). See Japan's Matchmakers. China Trade Report, v. 19, April 1981. pp. 13–14.

[6] An unofficial translation of the agreement is in China Newsletter, v. 25, June 1978.

[7] Ky Ying. China-Japan Trade. China's Foreign Trade, Feb. 1979, pp. 2–3.

Article 4 of the LTTA eliminated the political conditions previously required for Japanese companies to do business with the PRC. It states that transactions from the agreement would be conducted on the "basis of reasonable international prices and international trade practices."

Economic exchanges between China and Japan under the trade agreement rapidly expanded to levels exceeding even the most optimistic expectations. During the first six months of 1978, Japanese firms had contracted to sell almost $10 billion worth of exports to the PRC—the amount stipulated for the entire eight years of the agreement. In addition, in August of that year, the two countries signed a Treaty of Peace and Friendship which generated more optimism about future levels of trade. On September 14, 1978, therefore, the LTTA was extended five more years to 1990 with the total amount of two-way trade raised from $20 billion for the eight-year period to $80–$100 billion for the new thirteen-year span.

The LTTA extension also established a regular ministerial-level conference to discuss trade matters; provided for Japan's cooperation in developing China's electrical power, coal, and nonferrous metal industries; called for a treaty on science and technological exchange; permitted Japanese businesses to open offices in China; and recognized tentative acceptance by China of guidelines by the Organization for Economic Cooperation and Development (OECD) for calculating interest rates.

The LTTA along with its extension gave Japanese manufacturers a firm competitive position in vying with Western developed nations for China's business, despite a similar agreement on trade that had been reached between China and the European Economic Community.[8]

Sino-Japanese Peace and Friendship Treaty.—The Treaty of San Francisco which officially ended the war with Japan for the United States and forty-eight other Allied countries did not include either the Soviet Union or the PRC, although Taiwan did sign a separate peace treaty. The official termination of hostilities between the PRC and Japan, therefore, required a bilateral Treaty of Peace and Friendship. Article 8 of the Tanaka-Zhou joint statement in 1972, which normalized relations between the two countries, called for the conclusion of such a treaty.[9]

Two problems between China and Japan greatly hindered the smooth conclusion of the Treaty of Peace and Friendship and still remain unresolved. The first was the claim by each nation to the Senkaku (Tiao Yu-t'ai) Islands located between Okinawa and Taiwan. The second was the antihegemony clause which China insisted be included in the treaty.

Both China and Japan appear to have legitimate claims under international law to the Senkaku Islands located between Okinawa and Taiwan. The importance of the islands has been underscored by the possibility that sizable offshore oil deposits exist in their vicinity. Four months prior to the signing of the treaty, more than 100 Chinese fishing boats entered the waters around the islands.

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[8] Tracy Dahlby. Peking opens the door to Japan. Far Eastern Economic Review, v. 99, March 3, 1978. pp. 40–41.

[9] The Joint Statement is reprinted in Lee, op. cit., p. 111.

Chinese fishermen brandished placards laying claim to the islands and caused a wave of political pandemonium in Tokyo.[10] The flap was temporarily resolved when the Chinese stated the incursions were accidental. The two sides reached a "tacit understanding," according to Japan, that each side would not touch on the issue in order that normalization could proceed.[11]

One of the purposes for which China sought normalization of relations with Japan was to counter what it perceives as a growing military threat from the Soviet Union. The Tanaka-Zhou joint statement in 1972 contained a clause opposing efforts by any country to establish hegemony in the Asia-Pacific region. China insisted that such a clause also be included in the peace treaty, but "Tokyo resisted for fear of further angering Moscow, which viewed the clause as unmistakably anti-Sovet." [12] After three years of being deadlocked on this issue, a compromise was reached by inserting article IV into the treaty. This states that the treaty would not affect relations with third countries.[13]

GSP Tariff Treatment for China.—As of April 1980, Japan has granted the PRC preferential treatment for its exports to Japan under what is referred to as the Generalized System of Preferences. This action qualifies certain Chinese exports to be accorded reduced import duties within certain quota ceilings in Japan.[14] Japan had previously granted China most-favored-nation (MFN) status.

The Japanese preferential tariff system covers 75 agricultural and marine products as well as all mineral and industrial products except for about 25 items including oil, plywood, and raw silk (a major Chinese export). Agricultural and marine products have no quota ceilings and are accorded preferential tariffs that are 10 to 100 percent lower than MFN rates. Mineral and industrial products generally are without tariffs except for 48 commodities which have rates set at 50 percent of the MFN rates. Japan's formula for computing quota ceilings had to be adjusted to account for the increased volume of trade from China, ostensibly in order to prevent sudden increases in ceilings which would impact certain domestic industries adversely.

In order for a country to qualify for GSP treatment from Japan, its economy must be classified as less-developed, it must be a member of the United Nations Conference on Trade and Development (not the General Agreement on Tariffs and Trade as is required in the United States), and the action must be approved by a Japanese Cabinet Order.

Granting of GSP treatment for China is particularly significant for Japan because it marks the crumbling of a pillar upon which the Long-term Trade Agreement was based. The conceptual structure underlying the LTTA was that the PRC would be able to pay for its imports of technology, machinery, and other sophisticated products with exports of crude oil and coal. With the difficulty that China is experiencing in increasing its energy production, however, Japan is being compelled to ease the entry of Chinese exports of manufactured goods, many of which compete directly with Japanese products, in order to bring bilateral trade more into balance.

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[10] Susumu Awanohara. An ill wind from the Senkakus. Far Eastern Economic Review, v. 100, April 28, 1978. pp. 10–11.

[11] Chugoku, Gyosen Shutsugyo wa Guhatsu (China, fishing by fishing boats accidental). Asahi Shimbun, April 16, 1978. p. 1.

[12] Tracy Dahlby. Looking for a fancy phrase. Far Eastern Economic Review, v. 101, Aug. 18, 1978. pp. 40–41.

[13] The full text of the treaty is in the Beijing Review, v. 33, Aug. 18, 1978.

[14] Japan extends GSP tariff treatment to China. China Newsletter, June 1980. pp. 21–22.

LEVEL OF TRADE: MOSTLY UP BUT SOMETIMES DOWN

During the three decades following the Communist revolution in China, the level of bilateral trade with Japan has generally followed a steep upward trend but also has fallen dramatically during certain periods. From 1950 to 1956, total trade (exports plus imports) grew from $59.0 to $151.0 million under three private trade agreements. (See Table 1)

TABLE 1.—JAPAN'S TRADE WITH THE PEOPLE'S REPUBLIC OF CHINA, EXPORTS, IMPORTS, AND SHARES OF TOTAL TRADE, 1950–80

[Dollars in thousands]

	Japan's exports to the PRC	Japan's imports from the PRC	Japan's trade with the PRC as a percent of Japan's total trade	China's trade with Japan as a percent of China's total trade
1950	$19,633	$39,328	3.3	4.9
1956	67,339	83,447	2.6	4.8
1959	3,648	18,917	0.3	0.5
1966	315,150	306,237	3.2	14.6
1972	608,921	491,116	2.1	18.6
1973	1,039,494	974,010	2.7	20.4
1974	1,984,475	1,304,768	2.8	24.0
1975	2,258,577	1,531,076	3.3	26.0
1976	1,662,568	1,370,915	2.3	22.9
1977	1,938,643	1,546,902	2.3	23.2
1978	3,048,748	2,030,292	2.9	23.8
1979	3,698,670	2,954,781	3.1	22.6
1980	5,078,335	4,323,374	3.9	23.1

Note: Valuation is free-on-board for exports and customs clearance for imports.

Sources: Based on Bank of Japan, Economic Statistics Monthly: China Newsletter, March–April 1981, p. 32–36; Office of the Prime Minister, Japan Statistical Yearbook; and International Monetary Fund, International Financial Statistics.

In 1957, however, the breakdown in talks establishing a forth trade agreement combined with an incident in Nagasaki over a Chinese national flag caused the PRC to cancel about $100 million in import and export contracts. Within two years, total trade between the two countries had plummeted to $22.6 million.

In 1960, however, with the failure of the Great Leap Forward and the escalating Sino-Soviet confrontation, the PRC began again to encourage trade with Japan. By 1963, total trade had nearly regained the previous high recorded in 1956, and by 1966 had quadrupled to $621.4 million. The Cultural Revolution beginning in 1966 however, abruptly dampened both China's ability and inclination to rely on foreign trade. For the next two years, trade with Japan fell but in 1969 quickly recovered.

Following normalization of relations between the two countries in 1972 total trade has been growing at an average rate of 30.8 percent per year. In 1980 total bilateral trade reached $9,401.7 million with Japan's exports to the PRC at $5,078.3 million and imports at

$4,323.4 million. Barring dramatic political changes in the PRC, trade with Japan should continue to grow during the 1980s, although the rate of increase will likely moderate considerably. China's shopping list with Japan appears to be virtually endless. The major constraint seems to be China's ability to generate sufficient foreign exchange to pay for imports from Japan.

In terms of dependency, the PRC generally depends more on trade with Japan than Japan depends on trade with the PRC. Since the mid-1960s, Sino-Japanese trade has accounted for a significantly larger percentage of Chinese than Japanse trade. The bilateral trade comprises about 3 percent of Japanese external merchandise trade while it accounts for about 22 percent of China's. (According to Chinese statistics, in 1980, Japan accounted for 22.2 percent of Chinese exports and 26.0 percent of Chinese imports). While Japan is the PRC's largest trading partner, the PRC ranks fifth (up from seventh in 1979) in Japan's trade behind the United States, Saudia Arabia, Indonesia, and Australia. Japan's trade with the PRC is at about the same level as that with Taiwan, Korea, and Germany.

In general, Chinese imports from Japan also play a more significant role in the "four modernizations" than Japanese imports from China play in Japan's economic plans. Although China could procure many of Japan's exports of high technology equipment and steel products elsewhere, the combination of price, quality, and favorable financing would be difficult to match.

The bilateral balance of trade during the sixteen years from 1950 to 1965 favored China, which over that period ran a cumulative surplus of $281.3 million and an average surplus of $17.6 million per year. From 1966, however, the surplus swung to Japan's side with the Chinese incurring a cumulative bilateral trade deficit of $5,633.2 million over the next 15 years for an average of $375.5 million per year and a record $1,018.5 million in 1978.

China's bilateral trade deficit with Japan has recently been showing signs of narrowing. In 1980, for example, the trade would likely had been close to a balance were it not for a fourth-quarter surge in Japanese shipments of machinery and a rush of last-minute imports by local Chinese authorities in anticipation of tighter restrictions on their importing activities. During the fourth quarter, Chinese imports from Japan exceeded its exports by more than $500 million to balloon the 1980 trade deficit to $755 million, up from the 1979 level of $744 million.

As a percentage of two-way trade, however, China's bilateral deficit with Japan has declined from 20.1 percent in 1978, to 11.2 percent in 1979, and to 8.0 percent in 1980. China's policy of readjustment and the slowing of orders for new plant and equipment from Japan indicate that future bilateral trade is likely to be closer to balance. One forecast projects the Japanese surplus to disappear by 1983 and a $460 million deficit to appear by 1985.[15] This bodes well for U.S. exports to the PRC, in as much as a reduced deficit with Japan will ease the pressure of China to reduce its equally large deficit in trade with the United States. The PRC's trade surplus with Hong Kong of more than $2 billion per year, however, gives it considerable leeway to run bilateral deficits with other countries.

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[15] Japanese exports valued f.o.b. and imports from China c.i.f. Masahiko Ehashi. Boeki no Kozo to 1980 Nendai no Tenbo (Structure of trade and outlook for the 1980s) in Shigeru Ishikawa, ed. 1980 Nendai no Chugoku Keizai (The Chinese economy in the 1980s). Tokyo, Nihon Kokusaio Mondai Kenkyujo., 1980. p. 250.

COMMODITY COMPOSITION OF TRADE

The commodity composition of trade between the PRC and Japan attests to the complementarity of the two economies. Chinese exports to Japan consist primarily of raw materials, food, and light manufactures. Japanese exports to China, on the other hand, are comprised mainly of products of heavy industry and high technology.

As shown in Table 2, in 1980 over half of China's merchandise exports to Japan consisted of mineral products with crude oil alone accounting for 45.1 percent of the total. Coal exports, while still only about a tenth of the value of oil, nearly doubled between 1979 and 1980.

TABLE 2.—CHINA'S MERCHANDISE EXPORTS TO JAPAN BY COMMODITY, 1979-80. CUSTOMS CLEARANCE BASIS

[Dollar amounts in thousands]

Commodity	1979	1980	1980 share (percent)
Animal products of which	$285.606	$297,108	6.9
Fish and shellfish	182,536	181,979	4.2
Vegetable products	341,516	321,623	7.4
Mineral products of which	1,272,875	2,514,233	58.2
Coal	69,098	116,519	2.7
Crude oil	1,003,522	1,949,172	45.1
Textiles and textiles articles of which	679,323	682,967	15.8
Silk and silk fabrics	257,812	171,611	4.0
Cotton and cotton fabrics	104,731	92,180	2.1
Garments	161,716	230,704	5.3
Others	375,461	507,443	11.7
Total	2,954,781	4,323,374	100.0

Source: Japan External Trade Organization. Japan-China Trade: 1980 Statistics. China Newsletter. March-April 1981. p. 35.

Textiles and textile articles at 15.8 percent of total Chinese exports to Japan reflect China's comparative advantage in labor intensive and traditional silk products. Note, however, that garments have supplanted silk as China's major textile export to Japan. This reflects both increased Japanese protection of its silk industry and a rise in exports of finished clothing. Some of the clothing is being manufactured under compensatory trade arrangements, whereby China pays for imports of equipment with exports of specific commodities, many of which are manufactured according to Japanese specifications.[16] Chinese textile exports potentially could become a major point of friction in Japan, as it is in the other developed countries of the world. In textiles, Japanese industry competes directly with Chinese products.

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[16] For a typical case of Japanese sewing machines traded for pajama output, see Japan external Trade Organization. China: a Business Guide. Tokyo, JETRO, 1979. p. 157-9.

The remainder of the Chinese exports consist of agricultural products, meats, fish, shellfish, and miscellaneous articles, such as antiques, art work, building materials, and fireworks.

Japanese exports to the PRC, as shown in Table 3, consist primarily of products of heavy industry and high technology. Machinery and mechanical apparatus comprise 42.2 percent of the exports with nearly half of that accounted for by general machinery. Metals and metallic articles account for another 33.2 percent of Japanese exports to China. Iron and steel products alone account for nearly a third of Japan's exports to the PRC with a value of more than $1.5 billion per year. It is little wonder, therefore, that projects such as the Baoshan steel mill hold such appeal to Chinese planners.

TABLE 3.—JAPAN'S MERCHANDISE EXPORTS TO CHINA BY COMMODITY, 1979–80

[Dollar amounts in thousands]

Commodity	1979	1980	1980 share (percent)
Chemical goods of which	$486,083	$575,416	11.3
Chemical fertilizers	208,474	244,476	4.8
Metals and articles thereof of which	1,748,912	1,686,655	33.2
Iron and steel and articles thereof	1,725,791	1,618,233	31.9
Machinery and mechanized apparatus of which	1,134,043	2,154,309	42.2
General machinery	418,229	1,164,226	22.9
Electrical machinery	164,693	422,428	8.3
Transport machinery	429,814	426,746	8.4
Scientific, optical, and precision apparatus	121,307	140,909	2.8
Textiles and textile articles of which	164,127	403,900	8.0
Man-made fibers	50,839	156,127	3.1
Others	165,505	258,055	5.1
Total exports	3,698,670	5,078,335	100.0

Source: Japan External Trade Organization. Japan-China Trade: 1980 Statistics. China Newsletter. March–April 1981. p. 33.

Chemical goods comprise another 11.3 percent of Japanese exports to China, textiles and textile articles 8.0 percent and miscellaneous items 5.1 percent. Japanese textile exports to China consist almost entirely of synthetic fibers or yarns. This contrasts sharply with Chinese textile exports to Japan, which consist primarily of fabrics of silk and cotton as well as garments.

Little is reported about competition between domestic Chinese manfacturers and imports from Japan. This stems partly from the Chinese view of imports as a supplement to domestic production or a source of supply for goods not available domestically. Still, competition must exist in industries such as machine tools, steel products, and electronics equipment in which Chinese industry is reasonably well developed. In computers, for example, imports must exert acute pressures on Chinese production facilities that are turning out computers that are often one-of-a-kind and at least a generation behind those available from abroad.[17]

In the China market, Japanese exports often compete directly with those from the United States. Except in iron and steel products, in which Japan holds a major cost advantage and in agricultural goods, in which the United States holds dominant advantage, U.S. and Japanese firms frequently compete head-on for sales to China. Some evidence exists that political considerations intervene to favor one side or the other. Still, the ability of U.S. firms to compete with Japan in this market is one indicator of the international strength of U.S. industry.

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[17] Karen Berney. Computer sales to China. China Business Review, v. 7, September-October 1980. pp. 28–32.

In 1980, for example, while the United States exported $3,754.4 million in merchandise to China, Japan exported 5,078.3 million dollars' worth. For the United States, however, $2,258.9 million in exports were in agricultural products and cotton. In machinery exports, the United States shipped $164.7 in equipment (earth moving, material handling, data processing, and communications) and machine tools. During the same year, Japan exported $1,595.4 million or nearly 10 times as much machinery, including $1,171.6 million in non-electrical machinery (engines, pumps, lifting machinery, excavating machinery, and machine tools) and $423.8 million in electrical machinery (power machinery, television, telegraph, and furnaces). In iron and steel products, likewise, the United States exported $42.2 million to China in 1980 compared with $1,626.4 from Japan.[18]

Of course, trade between the United States and China is expanding rapidly from a small base. In 1980, U.S. exports to China were at approximately the level of Japan's in 1978. Japan's exports of machinery are also expected to taper off over the next few years as the backlog of deliveries of machinery for whole plants contracted during 1978 and 1979 are completed or terminated. The United States also leads Japan in sales to China of some highly sophisticated items such as aircraft and computers. Japan exports virtually no aircraft and despite U.S. restrictions on shipments of strategic equipment to China, cumulative U.S. sales of computers to China (as of fall 1980) totalled an estimated $152.9 million compared with Japan's $75.3 million.[19]

Still, a comparison of U.S. and Japanese sales to China indicates that Japan apparently holds a sizable advantage over the United States in selling non-agricultural goods to China. This is not inconsistent with U.S. and Japanese export performance in other third world markets. In general, Japan has been gaining position in manufactured exports, while the United States has been losing.[20]

While geographic proximity and lower costs of production contribute to Japan's industrial competitiveness, Japanese government policies also enhance Japan's ability to compete in China. Japan's government established official trading agreements and facilities quickly after normalization. The government also moved speedily to grant most-favored-nation status and preferential tariffs for China. Perhaps equally as important, however, has been the wide range of government industrial policy measures favoring industrial development and export competitiveness in Japan. Such measures include rapid depreciation schedules, favorable tax treatment, promotion of rationalization (efficiency in production), and an ample supply of credit.[21]

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[18] Data from U.S. Central Intelligence Agency, National Foreign Assessment Center. China: International Trade, Fourth Quarter, 1980. pp. 23-25.

[19] Berney, op. cit., pp 29-32.

[20] Eleanor M. Hadley, Japan's Export Competitiveness in Third World Markets. Significant Issues Series. Center for Strategic and International Studies, Georgetown University. 1981. p. 6.

BILATERAL TRADE ISSUES

Bilateral trade between the PRC and Japan benefits both countries but is not without problems. From China's viewpoint, the trade deficit with Japan has been large and chronic, although recently it has shown signs of disappearing. There is some asymmetry in the indirect benefits from the bilateral trade. The goods that China sells to Japan tend to be raw materials, food, and light manufacturers in which the value added is low and the technological spin-offs few, while the goods that Japan sells to the PRC tend to be products with high value added and technological spin-offs. Some of the advanced plant technology purchased from Japan also seems inappropriate for China's developing economy.

From Japan's viewpoint, the problems in trade with China have centered mainly on financing and vacillation in Chinese economic policy. Japan has been the major victim of the Chinese cancellation or postponement of investment projects. Japanese firms exporting plants to China have complained that because the Chinese reject foreign participation in project planning, they are precluded from conducting feasibility studies or other preparations.[22] Japan has also experienced difficulties in assimilating some Chinese products such as heavy petroleum which requires special equipment to refine.[23] Chinese silk and fishery exports also compete directly with two industries in Japan that are declining.[24]

The major benefits to Japan from the trade are diversification in sources of supply, in particular for energy, the development of a sizable, new export market, economic ties with the largest country in Asia, and the opportunity to assist an Asian nation with which Japan has close cultural affinity. China also sells certain items, such as silk and art works, unavailable from other markets.

For the PRC, trade with Japan also represents a diversification in sources of supply and a new market for Chinese exports. Certain Chinese products, such as textiles and garments, meet restricted markets in North America or Europe. Yet these are the products in which the PRC is perhaps the most competitive and most able to increase output quickly. In 1980, for example, China exported $403.9 million worth of textiles to Japan.

As the only major industrialized nation in Asia, Japan offers China a wide range of high-technology products at competitive prices and relatively short delivery times. Since much of the advanced technology available in Japan is embodied in machines and equipment, that technology can be obtained simply by purchasing the final product. The alternative cost of developing such technology domestically would be extremely high compared to buying it on the open market. In the words of a Chinese official, "A country cut off from the outside world can never be modernized."[25]

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[21] For further discussion, see Hadley, op. cit.

[22] Takuji Shimano. Overview. Economic Eye, v. 2, June 1981. p. 2.

[23] For further information, see Muneo Senno. Boeki (Trade) in Sueo Sekiguchi, ed. Chugoku Keizai wo Shindan Suru (Examining the Chinese economy). Tokyo, Japan Economic Research Center, 1979. pp. 18-22.

[24] The textile issue is discussed briefly in Sueo Sekiguchi, Chugoku Keizai to Nihon (The Chinese economy and Japan) in Sekiguchi, op. cit.

Except for items such as Chinese-character computers, however, most products from Japan could also be supplied by other nations, although prices might be higher. Japan, however, plays a key role in diversifying China's sources of supply in order to avoid a replay of the 1950s when it became overly dependent on machinery imports from the Soviet Union.

In general, the benefits to healthy trade between the PRC and Japan far outweigh the problems. Some of the problems, moreover, are expected to be resolved as political conditions stabilize in China and as the Chinese gain experience in international finance. Two major problems still unresolved, however, have been project cancellations and China's stagnating energy exports.

Project Cancellations.—In early 1981, China announced the cancellation or postponement of five major chemical and steel projects worth some $2.5 billion. (Some of the projects have subsequently been revived.) Of the countries affected, Japan was the hardest hit with approximately $1.5 billion worth of contracts at stake, including seven turn-key petrochemical plants and much of the Baoshan Iron and Steel Works near Shanghai.

This shift in stategy came as a direct outgrowth of the general policy of "readjustment" in China and the realization that China would have insufficient funds, both yen and yuan, to complete the projects. Domestically, Chinese government budgetary deficits, the resurgence of inflation, and public demands for more consumer goods required that China's rate of investment be reduced. Internationally, shortages of foreign exchange and China's growing foreign debt similarly required that investments in imported plant and equipment be curtailed. Rising world petroleum prices, stagnating Chinese petroleum output, shortages of raw materials and electricity, difficulties in construction, and the inappropriate technology of some Chinese imports (that is, technology that suited Japan's import- and export-oriented economy more than China's) resulted in the planned construction of some plants that were ill-conceived or ill-suited to China's economy and resource base.[26]

The Chinese estimate that each dollar spent for imports of whole plants requires between 7 to 9 yuan in internal Chinese funds for construction. Since 1978, the PRC had contracted for more than $7 billion in plant imports which would have required more than 50 to 60 billion yuan in funds for domestic construction.[27] With a national budget of some 120 billion yuan, it is little wonder readjustment became the order of the day in Beijing. The Baoshan steel complex alone is estimated to have accounted for about 7 percent of China's national budget.[28]

The contracts in question had been signed in 1979 and 1980, and Japanese companies were far along into filling the orders. In many cases as much as half of the equipment ordered had been produced and shipped or was waiting for loading at port when the cancellation notices were received.[29]

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[25] Speech by Lei Renmin, Vice Chairman and Vice President of the China International Trust and Investment Corporation before the Trilateral Member's Beijing Meeting, May 20-23, 1981.

[26] See Section III on Baoshan for details.

[27] Tsuyoshi Yamamoto. Semarareru Nihon Seifu no Taio (The Japanese government pressed for a response). Toa, April 1981. p. 42.

[28] Enerugi Shigen Mondai Chosakai. Chugoku no Enerugi Jijo to Sono Haikei (China's energy situation and its background). Enerugi Shigen Shosa Shiryo Dai 13-go, December 1980. p. 1.

The announcements of the contract problems took most Japanese by surprise, even though there had been some early warnings. Officials of both governments feared that the situation if left unattended could strain their economic relations. Both governments immediately dispatched officials to the other country to discuss the matter. The Japanese delegation to China emphasized repeatedly that the contract problems were unprecedented and that they were not pleased with the manner in which Japanese firms had been notified of the problem.[30]

The resolution of the issue proceeded first through a period of education when both sides reread the contracts and reviewed precendents to determine an appropriate course of action. The solutions proposed called for either invoking the Japanese government's export insurance, providing compensation for the firms involved, or continuing the projects through either loans or joint ventures.

Compensating Japanese firms through the government's export insurance was quickly ruled out when it was realized that that such action would require designating the PRC as a poor credit risk which would virtually eliminate future export insurance from the Japanese government, jeopardize yen credits from Japan's Export-Import Bank, and possibly end deferred-payment arrangement for Beijing.[31] This would place Japanese firms at a considerable competitive disadvantage in bidding for future contracts. Japan would also be required to notify other nations of the incident.

As for compensation paid by the PRC, the Chinese who have had but short experience in Western contractual law were dismayed to find that compensation for the cancelled contracts would cost so much that in cases it was less expensive to go ahead with the purchases. The possibility of reselling the equipment after delivery was explored but dismissed as impractical.

The obvious solution for the Chinese was to obtain outside financing, either from the Japanese government, from banks, or from private Japanese firms in the form of a joint venture. Joint ventures were generally ruled out, however, because of their high risk and questionable profitability.

What appears to have evolved from the Sino-Japanese negotiations will be Japanese credits of 200 billion yen (approximately $900 million) to keep the Baoshan steel mill and the Daqing petrochemical complex alive. The amount will be divided evenly between commodity loans and an Export-Import Bank loan. China originally sought 600 billion yen in financial assistance. Additional funds will be met by loans from commercial banking institutions.[32]

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[29] Masahiko Ishizuka. Japan-China economic ties become seriously strained. Japan Economic Journal, v. 19, Feb. 10, 1981. p. 1.

[30] Keiji Samejima. Japan-China Economic Exchange at the Crossroads. Economic Eye (translated from Nihon Keizai Shimbun, Feb. 27–28, 1981), v. 2, June 1981.

[31] John Lewis and David Bonavia. The honeymoon is over. Far Eastern Economic Review, v. 112, Feb. 20, 1981. p. 46.

[32] Y200 billion credit for Chinese projects. Japan Economic Journal, v. 19, June 30, 1981. p. 3.

Japan, however, fears that such loans to China could set a bad precedent that will invite other countries who encounter funding difficulties to appeal for similar financial assistance.[33] The loans also will not solve the PRC's internal funding problem. Even if part of the loan is used for internal construction, inflationary pressures cannot be avoided unless an equivalent amount of savings is generated domestically. Funding domestic expenditures through borrowing, even international borrowing, is still deficit spending.

The contract cancellations illustrate three major points. First, the Japanese government is willing to absorb some of the risks involved in exporting to China. Second, Japan values its friendly ties with the PRC to the extent that it is not willing to allow economic disputes to sour that relationship. And third, both Japan and the PRC are going through a learning process in dealing with each other that likely will lessen the probability of such problems occurring in the future.

Exports are important enough to the Japanese government that its export promotion policies have usually included some risk absorption. For normal business risks, the government provides export insurance, but in cases its has also assumed additional risks for projects jeopardized by political disturbances or balance-of-payments crises.[34]

In Iran, for example, the Japanese government took an equity of 20 billion yen in a petrochemical complex being constructed by the Mitsui company. The Iranian revolution and later the Iran-Iraq war not only halted the work on the project, but the unfinished plant was bombed. Mitsui had asked the Japanese government to designate the petrochemical complex as a "national project" in order to qualify it for favorable financing.[35]

The project cancellations did cause China's risk rating to deteriorate somewhat. In March 1980, the PRC was ranked number 20 from the top (least risky) among 100 major countries with a score of 72.2 (out of 100). By March 1981, that score had fallen one point to 71.2 dropping the PRC to 24th place behind Malayasia, Mexico, Ireland, and Denmark.[36]

The value of the contract dispute as a learning experience has been great. It is doubtful that Japanese firms in the future will sign contracts with the PRC that do not include specific provisions for compensation in case of default. Prior to the current incident, the PRC had maintained a sterling credit record and had backed its contractual obligations with other nations. After the Sino-Soviet split in 1960, China not only repaid its obligations to the Soviet Union but did so ahead of schedule. Japanese firms signing contracts with China had little reason to demand that compensation clauses be included.

Japanese firms also most likely will insist that they have a larger role in the design of and in conducting feasibility studies for future projects. One criticism of Japanese firms is that during contract negotiations, even though they could detect weaknesses in the project being considered, they apparently proceeded with the negotiations in order to conclude the sale. With the rising China fever in Japan and the predominant Japanese business strategy of maximizing market shares, a general attitude seemed to be that if China wanted to buy it, then why not sell it.[37] Japanese firms now realize that selling equipment for uneconomic projects not only can cause long-term damage to both the PRC and its development program, but it also can hinder the short-term ability of China to pay for and implement those projects.

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[33] Frank Ching. China will seek over $2 billion in Japan loans. Wall Street Journal, April 6, 1981. p. 26.

[34] Nagao Watanabe. Chugoku hayaku no haikei to taio (Background and reaction to China's contract cancellations). Toa, April 1981. pp. 29–31.

[35] Toshio Onda, et. al. Iran petrochemical complex construction will be resumed. Japan Economic Journal, v. 18, February 5, 1980. p. 1, p. 4. Time to freeze it. Editorial. Japan Economic Journal, v. 18, October 28, 1980. p. 10.

[36] Rating country risk. Institutional Investor, Sept. 1980, p. 283 and March 1981, p. 281.

Fortunately for both sides, the contract issue did not lead to excessive criticism and acrimony on either side. Japanese public opinion which is often quite volatile could have changed from irritation at the incident to harsh criticism. Deep-seated resentment against Japan in China could also have been touched off.[38]

China's Energy Exports to Japan.—An underlying premise of the Long-term Trade Agreement was that the PRC would export petroleum and coal to Japan in exchange for imports of machinery and equipment. The stagnation in China's petroleum production, increased domestic demand, and difficulties in modernizing coal mines and transportation facilities have resulted in the downscaling of projections of China's energy exports to Japan. During 1981, China announced that it would limit crude oil shipments to Japan to 166,000 barrels a day, 14 percent below what it pledged in the trade agreement and only slightly above the level for 1980. Some Japanese fear that oil exports to Japan could even disappear after 1985 unless Beijing accelerates the pace of offshore drilling and development.[39] The problem is not of ample reserves but in production and shipping. As Zhou En lai once said, "Even though resurces are plentiful, they are of no use unless they are dug up."[40]

The stagnation in China's petroleum exports to Japan carries serious consequences for the PRC, some of which have already appeared in the form of the contract cancellation incident in 1981. Petroleum exports not only were the key to imports of high technology machinery and equipment necessary for the four modernizations, but they were a link in the strategic chain by which the PRC attempted to keep Japan from entering into a "Japan-Soviet resource alliance" aimed at the development of coal and gas reserves in Siberia.[41] Even though Japan buys more than half of all Chinese petroleum exports, such exports supply only about 3 percent of total Japanese petroleum imports. With the stagnation in Chinese oil exports, the Siberian alternative becomes more attractive.[42]

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[37] Yamamoto, op. cit., p. 44.

[38] William Hwang. Prospects for Solution to Contract Issue. China Newsletter, No. 31, March-April 1981. p. 5.

[39] Raphael Pura. Japanese Hope of Using Oil Purchases to Fuel China Trade is Slipping Away. Wall Street Journal, Feb. 27, 1981. p. 26. Chugoku Sekyu wo meguru Yotsuno Nazo (Four riddles of Chinese oil). Ekonomisuto, March 25, 1980. pp. 16–20.

[40] Nitchu Keizai Koryu no Tenbo (Outlook for Sino-Japanese economic exchange). Keidanren Geppo, v. 27, October 24, 1978. p. 19.

[41] Katsutoshi Murakami. Ajia no Sekiyu (Asian petroleum). Tokyo, Nihon Kokusai Mondai Kenkyujo, 1980. pp. 232–34.

[42] With the 1981 lifting of the embargo on exports to the Soviet Union, Japanese companies are showing renewed interest in Siberian energy development.

Financial Assistance.—In 1979, when China shifted its external economic policies and began to seek foreign loans for the first time in decades, Japan was quick to respond with a promise of 500 million yen in loans for fiscal 1980 with an interest rate of 3 percent, 30 year repayment period, and 10 years of grace. The funds were earmarked for six major infrastructure projects (ports, railroads, and hydroelectric power). In total, Japan agreed to supply $1.5 billion in extra-low interest (3 percent) loans to China from the Japan Overseas Economic Cooperation Fund. Japan also extended a $2 billion, 15-year loan at 6.25 percent from the Japan Export-Import Bank. China reportedly has allocated between $1 and $1.5 billion of the loan for development of such resources as coal, oil, and copper.[43]

Such financial assistance which Japan provides to China to help in overcoming financial hurdles appears to be an important factor in Japan's success in doing business with China. Japan seems to have developed an integrated economic policy toward China that enhances bilateral trade. It backs its exports with a combination of risk insurance and financing as well as official government contacts. It also promotes good will by actions such as its agreement to construct a major hospital in Beijing and donate it to the people of China.[44]

SUMMARY

Sino-Japanese economic ties are flourishing under a series of trade and other agreements, although the China fever of the 1970's has been replaced by cautious optimism in the 1980s. China and Japan have close geographic proximity, extensive cultural ties, and a long history of commercial relations. During the twentieth century, however, bilateral ties have been severely strained by wars and Japan's support of the China containment policy pursued by the United States.

Following normalization of relations in 1972, trade has grown rapidly. Japan is China's largest trading partner, accounting for more than 20 percent of China's foreign trade, while China is Japan's fifth largest trading partner with about 3 percent of Japan's foreign trade. China tends to be more dependent on trade with Japan than Japan is on trade with China.

The framework under which Sino-Japanese relations are conducted include a Long-term Trade Agreement and a Treaty of Peace and Friendship. Under the trade agreement, China is to export crude oil and coal to Japan in exchange for Japanese exports of machinery and equipment. The peace treaty officially ended World War II, although conflicting claims to the Senkaku Islands and Chinese insistence on an anti-hegemony clause stalled the treaty negotiations for three years. Japan has also granted preferential tariffs to China under the Generalized System of Preferences.

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[43] Dori Jones. The dawning of coal's "Second Golden Age." China Business Review, v. 7, May/June 1980. p. 42.

[44] A new page for Japan-China economic relations. Oriental Economist, v. 48, Jan. 1980. p. 2.

Since 1965, China has incurred a cumulative deficit of $5,633.2 million in its merchanise trade with Japan. This deficit at $755 million in 1980 has been declining after its peak in 1978.

China exports mineral, textile, and agricultural products to Japan in exchange for metallic products and high technology machinery and equipment. Except in textiles and fishery products, the two economies tend to complement rather than compete with each other.

The bilateral trade problems include the large and chronic trade deficit in Japan's favor, contract suspensions or cancellations by the PRC, and stagnating Chinese exports of petroleum and coal. Japan's large trade deficit has declined from its peak in 1978. Many of the contracts which China cancelled in 1981 have been revived through loans either from the Japanese government or private banks. The constraints on growth in Chinese exports of petroleum and coal, however, indicate that Japan will have to make room in its economy for other Chinese exports in order for trade to increase during the 1980s.

For the United States, healthy Sino-Japanese trade contributes to stability in Asia and expands markets for each country's products. In terms of U.S.-Japanese competition in China's marketplace, the United States holds an advantage in agricultural products, aircraft, and computers, but Japan exports much more iron and steel products and machinery to China than the United States. The Japanese government has an integrated China policy that combines official ties, favorable financing, and risk reduction to back its China traders. Also important has been the government's general industrial policies which encourage export competitiveness, cost reductions and rational resource allocation.

CHINA'S GRAIN IMPORTS

By Frederic M. Surls*

INTRODUCTION

China has been a significant importer of grain since the early sixties. In the late seventies, however, China's grain purchases and importance in world grain markets rose sharply. This surge of imports has had an important impact on U.S. exports of grain, particularly wheat. During 1981 China was the leading export market for U.S. wheat, taking 17 percent of all U.S. exports. Since PRC purchases are concentrated in cheaper grades of wheat, China's impact in this sub-market has been particularly dramatic. During the 1980/81 wheat marketing year, sales to China of 6.2 million tons accounted for 73 percent of total U.S. exports of soft red winter wheat.[1] The US-PRC grain trade agreement, signed in October 1980, sets an annual range of 6-9 million tons for U.S. grain sales to China during the 4 year period which began in January 1981. China will therefore continue to be an important market for U.S. grain in years to come.[2]

This article reviews the evolution of China's grain import policy, examines the factors behind the recent surge in imports, and offers some tentative conclusions about China's intentions for future grain imports. It argues that while higher imports of grain and other farm products have been a necessary part of policies to increase food consumption and raise agricultural productivity, China has thus far not made a commitment to sustained future growth of imports of these products. In fact, greater grain imports seem designed to permit gradual reduction in levels of imports of other farm products, particularly cotton, sugar, and oilseeds. In addition, agricultural development policy is deemphasizing feed-intensive livestock programs and is slanted toward development of domestic sources of grain which are intended to gradually limit the need for imports.[3]

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[1] The U.S. wheat marketing year ends on May 31.

[2] The agreement sets a minimum annual purchase level of 6 million tons and a maximum of 8 million tons. Since an additional 1 million tons can be purchased annually without prior notification to the U.S., the effective annual range is 6-9 million tons. The text of the agreement is included as an appendix to this report.

[3] Agricultural trade policy and the determinants of import levels are covered more fully in two recent articles by the author—"New Directions in China's Agricultural Imports," American Journal of Agricultural Economics, Vol. 62, No. 2 (May 1980), pp. 349-355 and "Agriculture and Foreign Trade," The Chinese Agricultural Economy, Ed. Randolph Barker and Radha P. Sinha (Boulder, Colorado: Westview Press, forthcoming). Much of the material in this paper is taken from these two articles.

THE EVOLUTION OF GRAIN IMPORTS

China imports both wheat and coarse grains, but wheat accounts for the bulk of imports and much of the coarse grains imported have been for human consumption (table 1). Coarse grain purchases to date have been irregular and are likely strongly influenced by wheat availability and prices. China has not yet begun substantial purchases of coarse grains for feed or industrial use, although some corn is now purchased for livestock operations. Also, malting barley has recently been imported for beer production.

TABLE 1.—GRAIN TRADE BY CALENDAR YEAR

[In millions of tons]

Year	Imports			Exports			Net imports [2]
	Wheat	Others	Total	Rice [1]	Others	Total	
1952–55 average	0.01	0.05	0.06	0.34	0.05	0.39	(.33)
1956–60 average	.03	.06	.09	1.10	.14	1.24	(1.16)
1961–65 average	4.88	.85	5.73	.64	.20	.84	4.89
1966–70 average	4.62	.07	4.69	1.05	.09	1.14	3.55
1971	3.02	.12	3.14	1.47	.12	1.59	1.54
1972	4.25	.41	4.66	1.56	.16	1.72	2.94
1973	5.98	1.66	7.64	2.60	.07	2.67	4.98
1974	5.35	1.42	6.77	2.55	.14	2.69	4.08
1975	3.34	.12	3.46	1.98	.18	2.16	1.30
1976	1.92	.14	2.06	1.45	.22	1.67	0.39
1977	6.84	([3])	6.84	1.02	.11	1.13	5.71
1978	7.99	1.32	9.31	1.37	.07	1.44	7.87
1979	8.29	2.58	10.87	1.10	.09	1.19	9.68
1980	11.66	1.85	13.51	1.00	.10	1.10	12.41
1981 [4]	12.60	.80	13.40	.60	.10	.70	12.70

[1] Milled weight (approximately 68 percent of paddy weight).
[2] Total imports minus total exports. ( ) indicates net exports.
[3] Indicates less than 5,000 tons.
[4] Estimate.

Sources: 1952–75 data are from Frederic M. Surls, "China's Grain Trade," Joint Economic Committee, Chinese Economy Post-Mao (Washington: Government Printing Office, Nov. 1978), p. 655. The rice trade data from this study are revised for 1971–76 using the series from U.S. Dept. Agr., For Ag. Serv., Foreign Agriculture Circular: Grains, FG38–80, Dec. 19, 1980, p. 20. These revisions include estimated rice exports to Vietnam. Data for 1976–80 are from U.S. Dept. Agr., Econ. and Stat. Serv., Agricultural Situation: People's Republic of China, Review of 1980 and Outlook for 1981, Supplement 6 to WAS-24, June 1981 and from partner country trade statistics.

China's grain imports have passed through at least 3 distinct stages. During the fifties, the PRC was a net exporter, shipping sizable amounts of grain abroad and importing only insignificant amounts. This situation changed dramatically in 1961 when a precipitous drop in grain production in the aftermath of the Great Leap Forward created serious food shortages. Although per capita production largely recovered by the mid-sixties, imports of grain were institutionalized as a permanent source of supply for China's urban areas and as a means of relieving pressures on the rural areas. From 1961 on, China has been a net importer of grain.

Beginning in late 1972 grain imports again rose substantially. This coincided with the opening of trade between the U.S. and China and U.S. grain shipments to the PRC grew rapidly (table 2). In part, the rise in Chinese imports was in response to a fall in grain production during 1972. But is also seems to have been part of important modifications in domestic and foreign economic policy which began at that time. These modifications were forerunners of the liberalized policies of the late seventies.

TABLE 2.—U.S. GRAIN EXPORTS TO CHINA AND MARKET SHARE, 1971–80[1]

Year	Quantity—million tons			Market share—percent		
	Wheat	Corn	Total	Wheat	Corn	Total
1971	(²)	(²)	(²)	(²)	(²)	(²)
1972	0.57	0.38	0.94	13.3	96.4	20.3
1973	2.82	1.50	4.32	47.1	90.4	56.5
1974	1.91	.85	2.76	35.6	59.1	40.6
1975	(²)	(²)	(²)	(²)	(²)	(²)
1976	(²)	(²)	(²)	(²)	(²)	(²)
1977	(²)	(²)	(²)	(²)	(²)	(²)
1978	2.28	1.07	3.35	28.5	81.0	36.0
1979	1.60	2.39	4.00	19.4	95.0	36.8
1980	6.37	1.67	8.04	54.6	91.1	59.5
1981	7.62	0.47	8.09	60.5	77.0	61.3

[1] Direct exports plus transshipments through Canada.
[2] Indicates none.

Source: U.S. Dept. Agr., Econ. and Stat. Serv., Agricultural Situaton: People's Republic of China, Review of 1980 and Outlook for 1981, Supplement 6 to WAS-24, June 1981, and earlier issues of this annual report.

This spurt of imports was interrupted in the mid-seventies by domestic political turmoil, an unaniticipated trade deficit, and several years of good harvests. But with the emergence of new leadership and a new commitment to higher living standards in the late seventies, grain imports again rose rapidly. By 1980, imports were nearly double the level of 1977 and 77 percent above the level of 1973, the pre-1978 peak year. While grain imports were rising, rice exports were dropping off and net imports of grain in 1980 reached a level 2.5 times that of 1973.

The rapid growth of imports in the late seventies occurred despite rapidly rising domestic grain production. Per capita grain production in 1980 was 328 kg., 5 percent below the 1979 record but 8 percent over the level of 1977. Rising imports were driven largely by growing domestic demand and imported grain came to play a more important role in China than at any time since 1949. While imports in 1980 still accounted for only about 4 percent of grain production as measured by China, imports provided a sizable share—perhaps as much as one-third—of grain supplies for urban areas and amounted to 22 percent of China's wheat production.[4]

Substantial imports are apparently intended to continue in coming years. A total of about 15.5 million tons is likely in 1982. In addition to the long-term agreement with the United States, agreements are also in place with other major supplies. The magnitude of these agreements suggests planned imports in the 12–17 million ton range for the next several years (table 3).

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[4] In 1980, wheat, rice, and coarse grains accounted for 87 percent of reported Chinese grain production of 318 million tons. The balance was pulses, tubers, soybeans, and other minor grains.

TABLE 3.—CURRENT LONG-TERM GRAIN AGREEMENTS

[Amounts in millions of tons]

Country	Date signed	Grain	Amount	Delivery period [1]	Remarks
Argentina	Sept 1980	Wheat, corn, and soybeans.	1.0–1.5 annually.	1981–84	Actual sales usually by private contract with grain companies, although the Grain Board can also make direct sales.
Australia	Nov. 1981	Wheat	1.5 to 2.5 annually.	1982–84	All sales by Australian Wheat Board. Includes 12-month credit terms.
Canada	May 1982	Wheat	10.5 to 12.6 total.	Aug. 1982–July 1985.	All sales by Canadian Grain Board. Contains 18-month credit terms. Most recent purchases have been on cash basis because of high interest rates.
United States	Oct. 1980	Wheat and corn.	6 to 8 annually	1981–84	Option to purchase additional 1 million tons without prior notification. Corn to be 15–20 percent of sales, balance to be wheat. Actual sales by contract with grain companies. (See Appendix for text.)

[1] Calendar year unless otherwise specified.

Source: U.S. Dept. Agr., Econ, and Stat. Serv., "Agricultural Situation: People's Republic of China, Review of 1980 and Outlook for 1981, Supplement 6 to WAS–24, June 1981, p. 33.

Factors Determining Grain Imports

The amount of grain China buys is determined by a combination of foreign trade policy, foreign exchange availability, world market prices, and underlying domestic requirements. The factors influencing domestic requirements are outlined in Figure 1. The Chinese economy can be thought of as a 2 sector—rural and urban/industrial—system. Needs of the urban/industrial sector for both direct human consumption and for livestock operations are supplied primarily by the central government though, in the case of grains, supplies provided by the Ministry of Food.[5]

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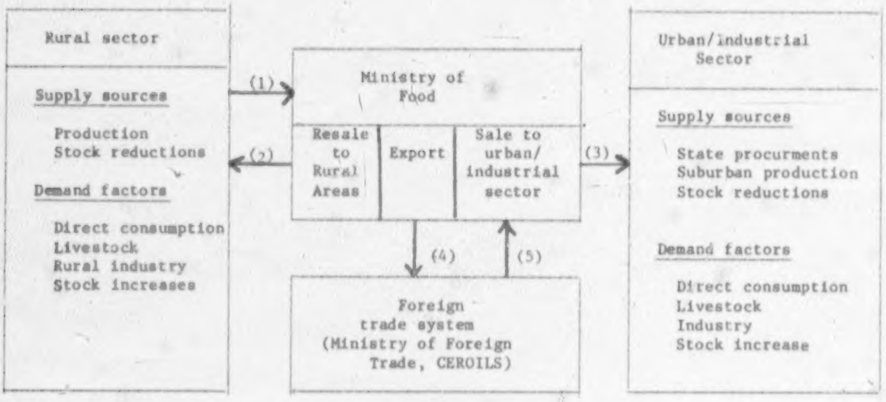
[5] The Ministry of Food merged with the Ministry of Commerce in early 1982.

Figure 1---Grain Transfers in China


Rural sector
Supply sources
Production
Stock reductions
Demand factors
Direct consumption
Livestock
Rural industry
Stock increases
(1)
(2)
Ministry of Food
Resale to Rural Areas
Export
Sale to urban/industrial sector
(3)
(4)
(5)
Foreign trade system (Ministry of Foreign Trade, CEROILS)
Urban/industrial Sector
Supply sources
State procurments
Suburban production
Stock reductions
Demand factors
Direct consumption
Livestock
Industry
Stock increase

→ Represents flows of grain

1: Government purchases from rural areas (gross)
2: Resale to rural areas
3: Sales by Ministry of Food to Urban/Industrial Sector
4: Exports
5: Imports

Grain supplies of the Ministry of Food are obtained either by purchase from the rural areas or by import through the foreign trade system.[6] Actual grain purchases from foreign countries are handled by CEROILS (China National Cereals, Oils and Foodstuffs Import and Export Corporation), which works under overall foreign trade plans drawn up by the Ministry of Foreign Trade.

In addition to providing for requirements of the urban/industrial sector, grain procured from rural areas by the Ministry of Food is also used for export and for resale to rural areas. Resales to the rural areas go to chronic food deficit areas, to regions whose production is down temporarily because of natural disasters, and to areas which are emphasizing production of cash crops at the expense of grain.

Policies implemented since 1977 have affected all of these flows in China's food system. Higher incomes, eased policies for transferring surplus population from the cities to rural areas, and some expansion of livestock operations in and around major urban centers all increased demands on the Ministry of Food for grain. During the late seventies, for example, China began constructing a limited number of small feed mills in urban areas which, by 1980, were producing approximately 1 million tons of mixed feed for urban livestock operations. Additions to central government stocks were likely also an additional source of demand.

At the same time, the central government eased pressures on rural areas for sale of grains as part of efforts to raise rural standards of living and provide greater incentives for agriculture. Between 1977 and 1980, rural sales of grain to the central government increased by only 4 to 5 million tons despite an increase of 35 million tons in national grain production.[7]

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[6] Some grain is also delivered to the government as agricultural tax payment. This is a relatively small amount and is not considered here.

In addition, government efforts to encourage cash crop production led to greater resales of grain to rural areas. This increase was a critical part of the incentives package for stimulating production of cotton, oilseeds, sugar crops, and other cash crops. Guaranteed food supplies for cash crop producers permitted them to shift area out of grain. Failure to guarantee food supplies had been a major reason for stagnating cash crop production in earlier years.[8] Requirements for resale and resupply to rural areas also rose in 1980 because of severe localized natural disasters, particularly drought in northern China and serious flooding in Hubei province in central China.

The combination of growing urban/industrial sector demand for grain and a net flow of grain from the rural areas which grew only slowly, was the major reason behind the surge of grain imports over the last 3 years.

PLANS FOR FUTURE GRAIN IMPORTS

Higher grain imports appear to have been a necessary condition for implementing key domestic policies of raising living standards and promoting cash crop production. Amounts set in current long-term agreements suggest that China intends to continue substantial imports in coming years. But there are real questions about whether future increases are intended and whether any substantial increase in coarse grain imports is planned.

China's agricultural import policy remains conservative and from the limited indications available shows no sign of evolving in the direction of accepting rising levels of imports and growing participation in international specialization as a desirable goal. As for grains, part of the reason for this caution is concern about becoming overly dependent on uncertain world markets for supplies of critical food items. A recent commentary in Red Flag noted that

> . . . it is necessary to import some grain each year. Since China has a huge population, however, the grain problem must be solved internally through self-reliance. At the same time, the supply of grain in the world market is limited and prices keep rising all the time. The method of importing more grain is therefore both unrealistic and unreliable.[9]

An additional reason for China's caution in agricultural import plans is to be found in other aspects of foreign trade. Despite curtailed imports of industrial goods during the current period of economic readjustment, over the longer-run China's leadership is likely still mainly concerned with imports of industrial goods and capital equipment. With export prospects uncertain and policy toward accumulation of debt remaining conservative, continued growth of food imports would eliminate China's traditional surplus in food trade and would curtail growth of industrial imports as the period of readjustment ends.

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[7] Production and procurement figures are summarized in U.S. Dept. Agr., Econ. and Stat. Serv., *Agricultural Situation: People's Republic of China, Review of 1980 and Outlook for 1981,* Supplement 6 to WAS-24, June 1981, p. 33.

[8] See "China's Agriculture in the Eighties" in vol. 1 of this report for more detailed information.

[9] Foreign Broadcast Information Service, "Daily Report: People's Republic of China," March 27, 1981, p. L-8.

For these reasons, China's agricultural trade policy appears to be one of import substitution, a policy whose objective is to halt the growth of agricultural imports and perhaps ultimately reduce them. As noted above, one reason for the increase in grain imports is to permit rapid growth of cash crop production, particularly production of cotton, oilseeds, and sugar. Imports of these items rose sharply in the late seventies. The increase in grain imports permits implementation of policies that may permit lower imports of other agricultural products.

Over the longer-run, an increase in the marketing rate for grain would generate growth of central government supplies at a rate greater than the overall rate of growth of grain production. This is one important reason for higher prices for grain now being paid by the government and for government emphasis on development of grain bases.[10] If the flow of grain from rural areas increases sufficiently, growth of requirements for resale to rural areas and for supply to the urban/industrial sector can be met from domestic sources rather than by imports.

As for the future of coarse grain imports, the government appears to be taking a cautious course. Livestock development programs have been modified to slow the expansion of concentrated feeding operations in and around the major urban centers. These rely primarily on government supplies of grain for feed. Slower development of this sector reduces the likelihood of feed demand becoming a major source of import demand in the near future. A recent cutback in the 1985 meat production target has the same effect. This evidence from domestic sources is supported by the terms of the recent U.S.-Chinese grain agreement, which stipulates that only 15-20 percent of total grain purchases from the U.S. will be coarse grains.

CONCLUSIONS

China's ability to limit future growth of grain imports will depend on both the success of programs to increase production and marketings and the growth of demand for government supplies of grain. Marketings have thus far shown little response to either higher purchase prices for grain or investment in development of grain bases. However, over the next several years some impact of these programs should begin to be felt and some rise in the marketing rate seems probable. Taken together with the increases in grain production that seem likely, marketings should rise by more than they have in recent years.

Demand for government supplies of grain in the eighties may grow at a slower pace than in the late seventies. The largest shifts of area from grain to cash crops have already occurred and future growth of grain requirements to support specialization should proceed at a slower pace. Slower growth of incomes in the urban/industrial sector is also likely. Although it is impossible to quantitatively assess the outcome of supply and demand shifts affecting government grain requirements and import demand, it seems possible that for the next several years no significant upward trend in grain imports will occur. Demand for better grades of wheat is likely to rise, however, as China moves to more blending of domestic and imported wheat.

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[10] For details see "China's Agriculture in the Eighties" in vol. 1 of this report.

This tentative conclusion applies only to the average level of imports. An important question about the annual variability of grain imports remains. During the sixties and the early seventies, China's purchases of foreign grain showed relatively little annual variability. This changed beginning in 1972 as shifting domestic and agricultural trade policies contributed to a marked increase in import instability (table 1). U.S. sales to China were particularly affected by this development, as the U.S. functioned largely as a residual supplier following the resumption of trade between China and the U.S. in 1972 (table 2).

The eighties may see a continuation of import instability, stemming from annual fluctuations in the supply of and demand for government grains rather than from frequent policy shifts. The Chinese government now has a stronger commitment to maintaining and raising standards of living than was the case in the past. Because of this, the government now seems less likely to pressure rural areas for grain supplies in years of poor harvests. It is also less likely to permit procurement shortfalls to be completely absorbed by lower consumption in the urban/industrial sector or reduced resales to rural areas. In addition, growing reliance on a limited number of commercial grain bases for government grain supplies may mean an increasingly narrow geographical base for these supplies and a resulting rise in the annual variability of supplies.

With greater pressure to support consumption levels, an increase in the variability of supplies of government grains, and continued unwillingness to permit retail prices of basic food items such as grain to fluctuate, China's requirements for imported grain could show significant instability during the eighties. This would be a destabilizing factor for world market grain prices. From the point of view of the United States, however, the US–PRC grain trade agreement should provide greater stability of grain exports than was the case during much of the seventies. The terms of the agreement preclude the U.S. bearing a disproportionate share of reductions in Chinese purchases during years when China's grain import demand declines.

APPENDIX

AGREEMENT ON GRAIN TRADE BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA

The Government of the United States of America and the Government of the People's Republic of China;

Acting in the spirit of the joint communique on the establishment of diplomatic relations between the Government of the United States of America and the Government of the People's Republic of China and the agreement on trade relations between the Government of the United States of America and the Government of the People's Republic of China;

Recognizing the importance of agricultural trade between our two nations;

Wishing to develop further agricultural trade relations between both countries on the basis of the principle of equality and mutual benefit.

Have agreed as follows:

ARTICLE I

1. The Government of the United States of America agrees to the supply, through normal private commercial organizations, for shipment to the People's Republic of China during each 12-month period beginning January 1, 1981, except as otherwise provided for in Article II, of a total quantity of at least 6 to 8 million metric tons of United States wheat and corn, of which approximately 15 to 20 percent will be corn.

2. The Government of the People's Republic of China agrees to purchase for shipment during each 12-month period beginning January 12, 1981, except as otherwise provided for in Article II, a total quantity of at least 6 to 8 million metric tons of United States wheat and corn, of which approximately 15 to 20 percent will be corn.

3. Purchases/sales of wheat and corn under this agreement will be made at market prices prevailing at the time of purchase and in accordance with normal commercial terms.

ARTICLE II

1. The Government of the United States of America shall endeavor to assure the availability of wheat and corn supplies through advance planning of production and stockbuilding fully to meet the import requirements of the People's Republic of China under the provisions of this agreement. If by virtue of exceptional circumstances necessitating the application of measures limiting the availability of United States wheat and corn in respect to all foreign purchases of United States grain, it becomes necessary in a particular year to supply less than the quantities specified in Article I, there shall be prior consultations between the two parties as to the amount of such adjustment. Any such measure which shall be applied to the exports of United States wheat and corn to the People's Republic of China shall be carried out on a basis no less favorable than to such exports to other foreign purchasers of United States grain.

2. If by virtue of exceptional circumstances making it impossible for the People's Republic of China to accommodate available supplies necessitating the reduction of minimum levels of normal imports from all foreign suppliers it becomes necessary in a particular year to purchase less than the quantities specified in Article I, there shall be prior consultations between the two parties as to the amount of such adjustment. Any such reduction of imports of United States wheat and corn which shall be applied to imports from the United States shall be carried out on a basis no less favorable than to imports from other foreign suppliers.

ARTICLE III

The United States of America expects to supply to the People's Republic of China and encourages the People's Republic of China to meet increased import requirements by purchases of wheat and corn from the United States. Therefore, if during the period that the agreement is in force, the People's Republic of China intends to purchase quantities of United States wheat and corn in excess of the 8 million metric tons specified in Article I by more than 1 million metric tons, there shall be prior notice to the Government of the United States of America. The Government of the United States of America shall promptly inform the Government of the People's Republic of China of any measures which may affect the availability of supplies of United States wheat and corn for purchase by the People's Republic of China beyond 9 million metric tons. This provision has the general purpose of facilitating the growth of trade through improving the availability of information.

ARTICLE IV

Both sides shall seek to avoid excessive volatility in their grain trade. To this end the Government of the People's Republic of China shall endeavor to space its purchases in the United States of America to enable orderly market adjustment. At the same time the Government of the United States of America shall seek to use its authorities to maintain the stability of United States market conditions for wheat and corn.

ARTICLE V

For the conduct of the consultations provided for in this agreement, the organization with the jurisdiction for the Chinese side will be the China National Cereals, Oils and Foodstuffs Import and Export Corporation. For the conduct of the consultations provided for in this agreement, the organization with jurisdiction for the United States side will be the Foreign Agricultural Service of the U.S. Department of Agricuture. Consultations regarding the conduct of trade under this agreement and regarding the over-all levels of United States export supply and Chinese import requirements for wheat and corn will be held prior to the beginning of each year covered by the agreement, or when requested by either party.

ARTICLE VI

The Government of the People's Republic of China shall assure that, except as the parties may otherwise agree, the wheat and corn grown in the United States of America and purchased by the China National Cereals, Oil, and Foodstuffs Import and Export Corporation under this agreement shall be supplied for consumption in the People's Republic of China.

ARTICLE VII

This agreement shall enter into force on January 1, 1981, and shall remain in force until December 31, 1984, unless both sides agree to an extension.

Done at Beijing this twenty second day of October, 1980, in duplicate, each copy in the English and Chinese languages, both texts being equally authentic.

For the Government of the United States of America:

For the Government of the People's Republic of China:

CHINA AND THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

By Florizelle B. Liser*

I. SUMMARY

Given the size and potential of the Chinese economy, the organization and management of that economy, the nature of a Contracting Party's obligations within GATT, and the complexities of certain methods of PRC entry into GATT, there are likely to be advantages as well as disadvantages for both China and the GATT should the PRC join. On the one hand, PRC entry into GATT would bring a major international power within the GATT framework, would extend some of the discipline of the international system to the conduct of China's foreign trade, and would provide a multilateral framework within which China's existing bilateral trade relations would evolve. On the other hand, GATT rules were formulated for market economies with effective tariff regimes. Experience to date with the smaller Eastern European centrally planned economies in GATT indicate that there are limits on their ability to do business in the spirit in which GATT was originally written, and one might assume that problems may arise in the PRC's ability or willingness to meet certain obligations inherent in GATT membership. Moreover, while accession of the PRC presents the same practical problems the GATT faces with the Eastern European countries (that is, how to make the GATT applicable to state trading countries whose economies are largely incompatible with GATT provisions), the PRC will be the largest and most politically influential non-market economy to enter GATT, and its entry could, therefore, have greater ramifications than that of other non-market economies.

Whether the advantages of the PRC's entry into GATT will outweigh the disadvantages will largely be determined by the mutual desire of the PRC and the GATT Contracting Parties to negotiate a method and terms of accession which will, on the one hand, be acceptable and feasible for China and will ensure, on the other hand, PRC adherence to GATT principles and obligations and effective Chinese reciprocity to GATT members.

II. INTRODUCTION

Since the launching of China's massive modernization campaign in 1978, there has been considerable interest not only in the nature of the campaign and its domestic implications, but in the impact this new modernization strategy would have on China's international economic and foreign relations. In the period since 1978 and throughout several readjustments in the strategy, China has clearly sought to expand its role in the international economic system, and this has been reflected in China's re-entry into international trade, financial and investment relations as well as its expanding participation and even membership in organizations such as the International Monetary Fund and the World Bank Group. Since the spring of 1980, the PRC has intermittently expressed its interest in GATT membership, and has informally explored this with the GATT Secretariat, the U.S. and presumably other GATT members. However, while the PRC's assumption of the "Taiwan" seats in the United Nations, IMF and World Bank has not posed particularly difficult problems, the special nature of GATT's work (i.e., specific country-by-country trade concessions) as well as the questions surrounding the validity of the Republic of China's (i.e., Taiwan's) withdrawal from GATT in 1950 makes the PRC's assumption of the former ROC seat in GATT a more complex issue. In fact, there are three possible avenues by which the PRC could achieve GATT membership status. Each route has its advantages and disadvantages, and reflects the interesting history of China's participation in GATT.

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III. HISTORY OF CHINA'S PARTICIPATION IN GATT

The Republic of China (presently called Taiwan) participated in the negotiations leading to the establishment of the General Agreement on Tariffs and Trade (GATT) in 1948. The ROC signed the Protocol of Provisional Application on April 21, 1948, became a GATT member on May 21, 1948, and was, thereby, one of the twenty-two original signatories to the GATT.[1]

During 1948, civil war erupted between the Nationalist Chinese Government and the Chinese Communists. The Nationalists retreated from the mainland to Taiwan, and by September 21, 1949 the People's Republic of China (PRC) was proclaimed and the Central People's Government was officially inaugurated on October 1, 1949 claiming state succession. Shortly thereafter, when a substantial number of GATT members in early 1950 had recognized the PRC as the sole legitimate Government of China, representatives of the ROC decided to withdraw from the agreement supposedly to forestall a move to seat the Chinese Communists. On March 1, 1950, General Chiang Kai-shek resumed the presidency of the Republic of China, and on March 6, 1950 (pursuant to paragraph 5 of the Protocol of Provisional Application), the ROC (by then located in Taiwan) notified the Secretary General of the United Nations of its withdrawal from the GATT. This became effective on May 5, 1950—sixty days after receipt by the Secretary General, and the Chinese schedule of tariff concessions (Schedule VIII) terminated at that time.

On December 11, 1950, the United States terminated the majority of the concessions it had originally negotiated with the ROC;

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[1] Australia, Belgium, Brazil, Burma, Canada, Ceylon (now Sri Lanka), Cuba, Czechoslovakia, France, India, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Rhodesia, South Africa, United Kingdom, United States, as well as Lebanon and Syria who, like China, have since withdrawn from the GATT.

and on January 25, 1952, a second group of tariff concessions was terminated—completing U.S. termination of concessions as a result of China's withdrawal from GATT. Between 1950 and 1962, thirteen other GATT members[2] withdrew the concessions they had originally negotiated with the ROC in 1948.

It was not until 1965 that China again participated in the GATT, when the ROC requested and was granted observer status. At that time, a number of countries reserved their legal position on nonrecognition of the ROC, but the general position by GATT members was that political considerations should not prevent observer status in the GATT. Following the seating of the PRC in the United Nations in November 1971, however, the ROC's observer status was terminated by a consensus of GATT Contracting Parties, though the United States and eight other CPs disassociated themselves from that consensus.[3]

IV. The Validity of the ROC's Withdrawal From GATT in 1950

The validity of the ROC's 1950 GATT withdrawal remains at issue, and has significant implications should the PRC pursue GATT membership status.

On one side of the issue it might be argued by the PRC that "China" has never validly ceased to be a member of GATT. That is, since the PRC became the successor to the rights and obligations of China on October 1, 1949, the withdrawal from GATT by the Republic of China (ROC), notified March 6, 1950 and effective May 5, 1950, was not valid because the Government of the ROC was not the legal Government of China. The PRC has traditionally taken the position that it has the right to choose which of China's pre-1949 international treaty commitments it will recognize, abrogate, revise or renegotiate, and has maintained that any international actions taken by the Taiwan authorities subsequent to the establishment of the PRC on October 1, 1949 are null and void. Though the PRC has recognized the validity of a few multilateral agreements signed by the ROC Government, the issue of the validity of Chinese withdrawal has not arisen in most other international organizations. In the U.N. and most of the specialized agencies, the ROC (i.e., Taiwan) continued to represent China until 1971. In October 1971 when the U.N. General Assembly voted that the only legal representative of China was the PRC, Taiwan ceased to be and the PRC simply became the legal representative of China in the U.N. Most U.N. organs and specialized agencies soon after voted to follow the General Assembly's decision, and this type of change of China representation more recently occurred in the International Monetary Fund and the World Bank Group in April 1980 and May 1980, respectively.

In the U.N. Food and Agriculture Organization (FAO) a different kind of change in China representation occurred in November 1971 when FAO members voted that although only the PRC could now represent China, the PRC should be invited to apply for membership given the Chinese withdrawal from the FAO in 1951. In response to the FAO Director General's invitation to apply for membership, the PRC took the position that it would be pleased to resume its membership in the FAO, and this was accomplished in 1973 after an FAO Team in China negotiated the appropriate arrangements for China to "resume membership". Some experts on PRC international law [4] surmise that the PRC's silence on treaties which it has neither acknowledged nor repudiated presumably "indicates that those treaties are not deemed to be binding, at least not until specifically accepted."

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[2] Australia, Benelux, Canada, Ceylon, Finland, France, India, Pakistan, Sweden, United Kingdom, Uruguay.

[3] The delegation of the Republic of China as well as those of Brazil, Gabon, Greece, Ivory Coast, Madagascar, South Africa, Spain, the U.S. and Zaire generally expressed the view that GATT, as an independent intergovernmental organization, had no legal obligation to follow decisions taken by the General Assembly of the United Nations.

On the other side of the issue, GATT Contracting Parties might argue that the ROC's withdrawal from GATT in 1950 was valid for the following reasons:

First, the ROC withdrawal was executed according to the specific procedures for withdrawal set out in GATT's Protocol of Provisional Application (i.e., paragraph 5) and was accepted as valid by all the Contracting Parties except Czechoslovakia which objected.[5]

Second, the PRC has acted as if the 1950 withdrawal was effective. The PRC took no steps to preserve its position at the time of Taiwan's withdrawal, has made no attempt to participate in GATT since 1950, nor has the PRC observed or applied the provisions of the General Agreement as if China membership continued to be effective.

Third, Taiwan has acted as if the withdrawal in 1950 was effective. When entering GATT as an observer in 1965, Taiwan paid—and GATT accepted payment of—dues delinquent between 1948 and 1950.

Finally, the GATT and its Contracting Parties have since 1950 acted as if the Chinese withdrawal was effective. In deciding to admit the ROC as an observer to GATT in 1965 and requiring that Taiwan pay the 1948 to 1950 dues on which it was in arrears at the time of the 1950 withdrawal, the GATT obviously considered the 1950 withdrawal valid since "China" could not be both a member and observer simultaneously. In addition, the GATT considered the ROC schedule terminated upon withdrawal in 1950 and fourteen CPs including the United States, terminated concessions originally granted to the ROC in the period following the withdrawal and did not apply GATT provisions to the PRC. Furthermore, certain GATT protocols since 1950 requiring unanimous acceptance and the signature of all CPs as a condition of entry into force were considered to enter into force without PRC participation or signature.

Hence, while there have generally been no difficulties in the PRC assuming the China seat in other international organizations, the CPs might argue that the GATT case can be distinguished by the fact that there was an ROC withdrawal, by the length of time between the ROC withdrawal and possible PRC entry, and the fact that the Contracting Parties have taken substantive actions in the intervening period (e.g. tariff concessions, amendments to the GATT, etc.) which would have required reciprocal concessions from the PRC or might have been different if the PRC had been considered a GATT Contracting Party.

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[4] See J. Cohen and H. Chiu, Peoples China and International Law, 1974, pp. 214, 1111, 1120-29.

[5] In December 1950 when the terms of the Torquay Protocol were drawn up, Czechoslovakia questioned the validity and effectiveness of the ROC withdrawal and unsuccessfully tried to have a note included in the Protocol to the effect that "The Nationalist Government of the Republic of China has notified its withdrawal from the General Agreement with effect from May 5, 1950; the Central People's Government of China has not yet defined its position with regard to the General Agreement."

V. METHODS AND IMPLICATIONS OF PRC MEMBERSHIP IN GATT

The continuing questions and arguments surrounding the ROC's withdrawal frm GATT in 1950 suggests three possible routes by which the PRC could achieve GATT membership status: (1) assumption of the China seat formerly held by the ROC; (2) negotiation of a new protocol of accession under GATT Article XXXIII; and (3) assumption of the Old China seat while negotiating new terms.

(1) ASSUMING THE OLD CHINA SEAT

By successfully challenging the validity of the 1950 ROC withdrawal, the PRC could assert the right to assume the former China seat in GATT. This would require, on the one hand, that the PRC conform its tariff to Schedule VIII as well as generally reform its trading regime to GATT rules. In addition, the PRC might be considered in default on thirty-one years of budget contributions or dues to GATT, and would thereby be obligated to pay those dues (approximately 2.6 million Swiss Francs as of 1980). However, depending on the decision of the Contracting Parties, this may pose problems only on a theoretical level since the PRC in assuming the China seat in other international organizations since 1971 has not been required to pay past dues, though an arrears or special account has generally been established.

On the other hand, PRC assumption of the Old China seat would pose several problems for GATT, the Contracting Parties, and particularly for the U.S. First, no Contracting Party to GATT would have the right to invoke Article XXXV (non-application) to the PRC since that article can only be invoked at the time of a country's accession (or 1948 in the case of China). This would pose particular difficulties for the U.S. since we could not grant the PRC unlimited, unconditional MFN treatment as required by GATT Article I and simultaneously ensure adherence to U.S. law. Under Title IV of the Trade Act of 1974, the U.S. is prohibited from extending unconditional MFN to communist countries whose products did not receive MFN treatment in 1974. The U.S. can only extend MFN to those countries on the terms provided for in the Trade Act of 1974, which require that any bilateral commercial agreement extending MFN to a communist country be renewed every three years. Moreover, U.S. extension of MFN treatment and/or of credits or investment guarantees to the PRC are subject to Section 402 of the Trade Act of 1974 (also known as the Jackson-Vanik Amendment) which prohibits such benefits to communist countries if they deny freedom of emigration. Although the President has authority to waive this restriction each year with respect to specific countries, each annual extension is subject to Congressional review and may be terminated by either House of Congress. Since the U.S. did not extend MFN to Chinese products until February 1, 1980 when the U.S.-PRC Bilateral Trade Agreement went into effect, the above restrictions and conditions of U.S. trade law are fully applicable to the PRC. The U.S. must therefore, ensure that it can comply with the provisions of U.S. trade law without violating its GATT obligations, and would have to seek some other form of non-application of the GATT to China if it could not invoke Article XXXV. This could take the form of the 1951 GATT declaration allowing the U.S. and Czechoslovakia to suspend their GATT obligations with regard to each other. After the communist party took Power in Czechoslovakia in 1948, the U.S. maintained that events within that country—including the nationalization of enterprises and the establishment of a trade monopoly—made normal trade relations under GATT impossible. The U.S. could not, however, invoke non-application of the GATT under Article XXXV (which would only have been applicable at the time of Czechoslovakia's accession to GATT in 1948), and instead proposed to seek a waiver under Article XXV(5). In the final declaration adopted by the CPs on September 27, 1951, it was decided that the U.S. and Czechoslovakia be allowed under the exceptional circumstances to mutually suspend their GATT relations without reference to a specific GATT article. Were the PRC to assume the Old China seat, the U.S. would need recourse to a similar kind of declaration, but this would be subject to PRC agreement as well as the approval of the GATT Contracting Parties.

PRC assumption of the Old China seat could raise several additional problems for the U.S. First, immediate PRC assumption of the former ROC seat in GATT would accelerate a U.S. decision on designating the PRC as a beneficiary developing country eligible for U.S GSP (Generalized System of Preferences). It appears that China has several motivations in seeking GATT membership. As economic and trade relations with foreign countries assume increased importance in its economy, China has sought to play a greater role in international economic organizations, and GATT membership would be a logical extension, of this trend. There is also the symbolic aspect in that GATT is one of the few remaining international organizations where the PRC has not yet taken the China seat. Finally, one primary motive for pursuing GATT membership would seem to be the Chinese interest in and desire to be eligible for U.S. GSP. Under Section 502(b)(1) of the U.S. Trade Act of 1974, communist countries may be eligible for GSP designation only if (1) their products receive MFN treatment by the U.S. (2) they are members of the IMF and Contracting Parties to the GATT, and (3) they are not dominated or controlled by international communism. If the PRC were to assume the old Taiwan seat and was, therefore, considered a Contracting Party to GATT, conditions (1) and (2) would have been met. The President would then have to determine condition (3) and subsequently make a unilateral decision on whether to grant them GSP after consulting with the U.S. Congress and private sector.

Second, PRC assumption of the Old China seat would theoretically raise problems for the U.S. regarding our recognition of the legal status of post—1949 acts taken by Taiwan. The PRC assuming the old seat after successfully challenging the 1950 ROC withdrawal could call into question the legality of any number of actions

Taiwan has taken on behalf of China since 1950, and could be conceptually inconsistent with the U.S. position, set out by President Carter in a December 1978 memorandum and supported by Congress in the Taiwan Relations Act, regarding the continuing validity of U.S.-Taiwan agreements previously concluded.

Perhaps more important than the special problems raised for the U.S., PRC assumption of the seat originally held by the ROC would create certain difficulties for the GATT and its Contracting Parties since they have acted as if China were not a GATT member. Specifically, a number of actions the CPs have taken since 1950 would be called into question, including the withdrawal of concessions to China as well as the entry into force of protocols of rectification and modification requiring the approval of all Contracting Parties. On the one hand, it is conceivable that certain GATT CPs would have to restore concessions originally granted to the ROC or would have to conpensate the PRC for having withdrawn concessions and MFN treatment. On the other hand, the PRC would then owe the CPs compensation for not having applied since 1950 the bound rates of duty under the original ROC schedule which are considerably lower than present PRC tariff rates. Many CPs, including some of those which withdrew their original tariff concessions to the ROC, now grant MFN treatment to the PRC and probably give PRC products better tariff treatment than previously negotiated with the ROC. Nonetheless, should the PRC assume the Old China seat, GATT as well as many of its members would be faced with solving some potentially complex and technical problems.

(2) NEGOTIATING A NEW PROTOCOL OF ACCESSION UNDER ARTICLE XXXIII

Should the PRC accede to GATT under Article XXXIII (accession by a government not party to the General Agreement), there would be no need to debate the former GATT participation of the ROC and, more important, GATT and its Contracting Parties could avoid the complex and technical difficulties of restoring a balance of benefits between the CPs and the PRC after thirty-one years of non-application. Under Article XXXIII provisions, the PRC would apply to accede and would have to negotiate appropriate terms of accession including a package of trade benefits with various GATT CPs. As with all countries which want to accede to GATT under Article XXXIII, a working party would more than likely be established to examine generally the PRC's trade system and patterns. More specifically, the WP would likely examine the extent to which the PRC's trade decisions are made by the central plan and most importantly, whether the PRC's tariff regime is an effective regulator of its foreign trade. Based on this examination, the working party would determine the most effective means for China to provide reciprocity to the other CPs in return for the benefits of GATT membership. Once an accession protocol had been approved by a two-thirds majority of the CPs and was accepted by China, the PRC would become a full Contracting Party to the GATT. This process of fully acceding to GATT under Article XXXIII could obviously take several years, but the PRC could also accede provisionally while negotiating an accession protocol under Article XXXIII.

Provisional accession would involve a declaration by some Contracting Parties to extend to the PRC the provisions of GATT, except tariff concessions, on a reciprocal basis.

Whether the PRC accedes under Article XXXIII or accedes provisionally while negotiating Article XXXIII accession, certain difficulties inherent in their assuming the Old China seat would be circumvented or avoided altogether. For example, GATT and the CPs would not need to make any decisions and/or take compensatory action regarding certain GATT actions taken since 1950 or on any tariff concessions withdrawn since that time. In addition, the U.S. would be able to invoke Article XXXV at the time that the PRC became a GATT member thereby avoiding any potential conflicts with U.S. trade law. Moreover, PRC accession under Article XXXIII would delay the need to make a decision on PRC eligibility for U.S. GSP since the PRC could only be considered a Contracting Party as required by Section 502(b)(1) of the Trade Act of 1974 at the conclusion of the accession process—one which could, as said earlier, take several years. Finally, PRC accession to GATT under Article XXXIII would avoid any problems for the GATT, the U.S. and other CPs regarding any actions taken by and/or with Taiwan since its withdrawal from GATT in 1950.

(3) ASSUMING THE OLD SEAT AND NEGOTIATING NEW TERMS

Given the economic and political motivations the PRC, on the one hand, may have in pursuing GATT membership and the political sensitivities and practical concerns the Contracting Parties, on the other hand, will likely have should the PRC decide to join, it is possible that the CPs might agree to the PRC's likely request to assume the Old China seat provided the PRC agrees to negotiate a special protocol document. This seems to be a likely outcome since many CPs would not want to challenge the legitimacy of the PRC's claim to the old seat and would probably welcome PRC participation in GATT despite the legal problems and technical complexities. This method of entry might also suit the PRC since it could claim its "rightful" seat in GATT, gain full LDC benefits under the "modern" GATT as opposed to the original 1948 terms, and could achieve GATT membership status as quickly as possible—a factor which could precipitate their eligibility for U.S. GSP.

A special accession or protocol document providing for PRC assumption of the Old China seat as well as new, more appropriate terms for Chinese participation in GATT could be implemented in several ways—including an Article XXV(5) waiver and modifications in schedules under Article XXVIII. Most important, a special protocol document would address the issues normally resolved in the Article XXXIII accession process. While there is no GATT precedent on which to base this action, allowing the PRC to assume the Old China seat provided it negotiates new terms of accession would address the special relationship China has had with GATT as well as resolve most of the problems which would arise if the PRC were simply to assume the old seat. It would, for example, provide a way to restore the balance of benefits between the CPs and the PRC after thirty-one years of non-application; would resolve possible compensation problems; could authorize the U.S. and PRC to suspend GATT provisions with regard to each other since Article XXXV could not be used; and, most important, would determine via findings of a GATT working party whether the PRC's tariffs are effective and, if not, what sort of import commitment and/or other concession from the PRC would be appropriate.

VI. CRITICAL ISSUES IN NON-MARKET ECONOMY (NME) ACCESSION TO GATT

The accession of Poland in 1967, Romania in 1971 and Hungary in 1973 under special GATT protocols recognizing the particular nature of their economies brought the total number of non-market economy countries in GATT to five—including Cuba and Czechoslovakia which were original members of GATT in 1948 before they converted to state-trading economies. GATT's experience to date with smaller, Eastern European non-market economies suggests both advantages and disadvantages in the accession of any NME into GATT, and perhaps more so for a large, developing-country NME such as China.

(1) ADVANTAGES OF NME GATT MEMBERSHIP

In addition to the political considerations of wanting to strengthen Eastern European ties with the West and lessen their dependence on the Soviet Union, GATT members felt that their participation in GATT would bring a large block of trade taking place outside of GATT within its parameters and would thereby encourage these countries to play by the established rules of the international economic and trade systems. In addition, it was felt that Eastern European membership in GATT would legitimize the GATT CPs as acceptable trade partners for those countries and would improve the opportunities for the CPs to increase their exports of agricultural and manufactured products to Eastern Europe. Most important, it was hoped that allowing the non-market economies of Eastern Europe to join GATT would reinforce their decisions to reform their domestic economies, to increase their economic and trade dealings with the West, and would result in more decentralized market-oriented policies.

(2) DISADVANTAGES OF NME GATT MEMBERSHIP

These advantages, however, have had to be weighed against the disadvantages of NME membership in GATT. Problems with the entry and participation of non-market economies in GATT have revolved around their ability to guarantee MFN treatment, the absence of GATT rules on state trading to the extent practiced by the NMEs and, most important, the effectiveness of their tariffs and ability to provide reciprocity to GATT Contracting Parties.

Accession to GATT requires undertaking a basic commitment by the acceding country to treat the products of one Contracting Party no less favorably than the same products from another GATT member. However, because the government in non-market economies, rather than market forces, operates all trading enterprises and determines in a central plan which goods will be produced, which imported and in what quantities, it was difficult for the CPs to be guaranteed that all trading partners of the Eastern European NMEs would receive equal treatment. State trading enterprises, for example, would not be able to follow their governments' foreign trade plans, on the one hand, and completely adhere to the GATT principle of non-discrimination or MFN in their actual operations on the other. Moreover, due to the insulation of their price structures from world market prices, genuine cost comparisons between alternatives sources of supply are generally not available in non-market economies.

As to GATT rules which might address the special nature of non-market economies, the GATT CPs realized that although GATT Article XVII ("State Trading Enterprises") attempts to address instruments of government trade regulation used in market economies, this GATT provision could not effectively deal with the degree of government intervention in trade inherent in the non-market economies.

Finally, the GATT CPs found that several NMEs wishing to enter GATT (i.e. Poland and Romania) had tariffs which were fairly meaningless. That is, in contrast to market-economy countries where tariff rates have a direct effect on the sources and composition of trade and where the tariff system is the principal regulator of foreign trade, the tariffs of non-market economies play only a minor role in determining the direction and composition of foreign trade.

The problems surrounding the accession to GATT of the Eastern European NMEs highlighted the fact that the GATT was originally written to address the trade problems of market-economy countries with effective tariff regimes. Hence, in order to effectively incorporate the non-market economies, it was clear that GATT would, generally, need to adapt its provisions to meet their special needs and, more specifically, would have to find new ways of ensuring reciprocity between the NMEs and the GATT Contracting Parties.

(3) TERMS OF NME ACCESSION TO GATT

When Poland and Romania acceded to GATT in 1967 and 1971 respectively, the Contracting Parties required that they agree to import commitments in place of a schedule of tariff concessions since their tariff systems were not considered by GATT Working Parties to be effective regulators of trade. Poland's import commitment requires that Poland increase its imports from GATT CPs by seven percent annually. This import commitment has turned out to be unrealistic, and Poland—after exceeding its commitment in the initial years following GATT accession—has not been economically able to achieve the prescribed level of imports from GATT members in more recent years. Romania's import commitment stipulates that its imports from the GATT CPs as a whole should increase at a rate not smaller than the growth of total Romanian imports provided for in its Five Year Plans. The Romanian import commitment has been more successful than the Polish commitment because it is responsive to Romania's overall growth and provides more flexibility in ensuring the GATT CPs of a fair share of the Romanian market. Since acceding to GATT, both countries have introduced tariff regimes which they now claim directly influence their trade. The Working Party on the Romanian customs tariff, convened in 1974, has not yet made a conclusive decision as to the effectiveness of those tariffs, and the Polish tariff regime has not been submitted to a GATT Working Party for examination.

In contrast to Poland and Romania which acceded to GATT on the basis of import commitments, a working party examining Hungary's trade regime found that its tariffs were an effective regulator of trade, and Hungary, in 1973, became the first non-market economy country to accede to the GATT on the basis of a tariff schedule.

Notwithstanding this difference, the protocols of accession to GATT for Poland, Romania and Hungary have had several common elements. In each case the GATT Contracting Parties agreed to gradually reduce all discriminatory quantitative restrictions on imports from these countries. The CPs reserved their right, however, to take discriminatory safeguard action against the acceding NME's exports if they cause serious injury to domestic producers. This safeguard reservation is contrary to GATT Article XIX which provides for non-discriminatory emergency action directed against the product, not the country of origin. Finally, the accession protocols of Poland, Romania and Hungary have provided for mutual withdrawal of equivalent concessions in the event of a dispute concerning NME accession commitments.

VII. Terms of PRC Accession to GATT

Despite the basic similarities between the economies of the Eastern European countries and that of the People's Republic of China and the conclusions one might draw for China based on GATT's experience with other non-market economies, the PRC is clearly distinct from the other NMEs which have thus far acceded to GATT. In contrast to Poland, Romania and Hungary at the time of their respective accessions to GATT, the PRC already trades extensively outside the communist sphere, receives non-discriminatory tariff treatment (MFN) from most GATT members, and is a very large, developing country with considerable economic potential.

Hence, while GATT will need to take into account its experience to date with other non-market economies, China's accession will also require that the Contracting Parties search for terms of accession uniquely responsive to the PRC. Such terms will, on the one hand, need to be acceptable and feasible for China and will have to ensure, on the other hand, PRC adherence to GATT principles and obligations and effective Chinese reciprocity to the Contracting Parties. Negotiating these terms will, no doubt, be difficult, and further emphasizes the importance of the PRC's terms of accession and their implications for the PRC, the Contracting Parties and GATT as an institution. If the PRC assumes the Old China seat, its GATT obligations would be meaningless without updated terms, and if it accedes under Article XXXIII, it would have to negotiate new accession terms in any case. One can, therefore, conclude that the PRC's impact on GATT, should it decide to join, will largely depend on the terms rather than the method of entry as well as on the overall effect such a large, developing non-market economy could have on the GATT.

Although the PRC has apparently expressed an interest in entering GATT on the basis of their tariff system as Hungary did in 1973, it is not yet clear whether concessions based on China's tariff schedule would provide effective reciprocity to the GATT Contracting Parties. China is reported to have at present a tariff system calling for two tariff classifications, including a "minimum" tariff denoting MFN treatment. However, these tariffs reportedly influence the domestic price of only 20 percent of total PRC imports, while the remaining 80 percent seem to be priced according to their Chinese-produced equivalents. If true, one might conclude that tariffs are not a significant factor in the PRC foreign trade regime and that Chinese import decisions are largely determined by the PRC plan of import rights and by allocations of foreign exchange.

If China's tariffs would not be acceptable as an effective regulator of trade, the CPs would need to negotiate some sort of commitment from the PRC which would reciprocate their tariff concessions to China. Since, however, the import commitments negotiated with other NMEs have not been particularly effective surrogates for tariff concessions, GATT may—in the case of PRC accession—want to develop a new sort of import commitment for the Chinese which would be both effective and appropriate. Such an import commitment might, for example, link the growth of PRC imports from GATT CPs to its growth in industrial production or in GNP, or might be based on sector-specific categories.

In addition to some sort of commitment (import or otherwise) which would reciprocate the benefits of GATT membership, the GATT CPs would probably want Chinese terms of accession to include measures to safeguard against market disruption caused by Chinese exports, provisions for greater transparency in China's trade decisions, and the establishment of a GATT working party to review on a regular basis China's trade relationship with GATT CPs.

From the PRC's point of view, it is likely that in acceding to GATT it would seek a commitment from the GATT CPs to progressively remove and/or eliminate quantitative restrictions affecting its products, and would—as a developing country—probably seek more advantageous terms than those negotiated by developed NMEs which have acceded to GATT (i.e., Poland and Hungary).

VIII. CONCLUSION

For China, entry into GATT would yield all the economic benefits of being in the GATT framework, such as permanent MFN treatment, innumerable tariff concessions, and access to GATT's trade dispute mechanisms. Moreover, GATT membership would give China the political benefits of playing a greater role in the international economic system. On the other hand, GATT membership could place considerable pressures on China to reform its economic system—something which might be politically undesirable or impossible from a domestic viewpoint.

For the GATT and its Contracting Parties, there are also certain advantages and disadvantages in PRC membership in GATT. On the one hand, PRC entry would bring a major international power within the GATT framework, would extend some of the discipline of the international system to the conduct of China's foreign trade, and would provide a multilateral framework within which China's existing bilateral trade relations would evolve. On the other hand, GATT rules were formulated for market economies with effective tariff regimes, and PRC accession to GATT could put additional strains on GATT as an institution to adjust its framework and provisions even more than has been required by the accession of the smaller, Eastern European NMEs. Finally, the PRC would be the largest and most politically influential NME to join GATT, and its entry might serve as a precedent for the Soviet Union—a factor which would have enormous ramifications for GATT.

Based on the present situation of economic retrenchment in the PRC, it is not at all certain whether the PRC will, in fact, pursue GATT membership in the near future. Nonetheless, at whatever point the PRC decides to pursue GATT membership, the GATT and its Contracting Parties will need to carefully review the complex issues at stake in Chinese accession as well as the possible advantages and disadvantages of their participation in the General Agreement on Traiffs and Trade (GATT).

V. SINO-AMERICAN NORMALIZATION

NORMALIZATION OF U.S. COMMERCIAL RELATIONS WITH THE PEOPLE'S REPUBLIC OF CHINA: UNITED STATES STATUTORY AND REGULATORY ASPECTS

By Vladimir N. Pregelj*

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INTRODUCTION

For over two decades following the Communist takeover of China, commercial relations between the United States and "Mainland China" were virtually nonexistent. During most of that period, the standstill was principally the result of a comprehensive embargo that the United States imposed on trade with Mainland China after the direct involvement of the Communist Chinese in the Korean War. The restrictions applied not only to trade but also to various other trade-related activities and affected as well certain firms in foreign countries over which the United States claimed jurisdiction.

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The political rapprochement between the United States and the People's Republic of China that followed the thaw triggered by the "ping-pong diplomacy" brought with it a gradual elimination of regulatory restrictions, at first—in mid-1969—only of peripheral ones and later of more substantive ones. The embargo on commercial relations with the PRC was lifted in mid-1971, and by legislative action the PRC's access to some U.S. Commodity Credit Corporation programs was authorized in 1978, a bilateral trade agreement between the United States and the PRC, providing among other things for the reciprocal granting of most-favored-nation status, was approved in 1979, and the PRC's eligiblity for the operations of the Overseas Private Investment Corporation was authorized in 1980. Also in 1979, the PRC gained access to Eximbank export credit facilities.

The U.S. action over the last decade, which eliminated or mitigated the earlier severe restrictions on commercial relations with the People's Republic of China, has placed the latter generally at least in the same position as the more favored European Communist countries with respect to the U.S. foreign commercial policy. In fact, there is evident in the present U.S. official position toward trade with China a certain degree of favoritism.

It should be understood that the restrictions that did or still do apply to China—with one exception—have not been enacted or implemented with respect to China as an individual country but rather as one of the group of "Communist," "nonmarket economy," or "State-controlled-economy" countries to which such restrictions apply collectively. Whatever action has been taken thus far to bring the PRC's commercial status with respect to the United States closer to normal has been in the form of individual exceptions to the policy applicable generally to this category of countries. Such normalizing action has been taken either administratively within the existing legislation (which at times requires prior compliance with more or less cumbersome conditions) or legislatively by the approval of a specific law exempting China from an otherwise still applicable statutory restriction that still remains in force with respect to other Communist countries.

With all this, the U.S. commercial policy toward the PRC and trade relations with it still are not normal in the sense that one would characterize as "normal" the policy toward and relations with the countries of the non-Communist world. Apart from a certain degree of unavoidable functional abnormality that is inherent in trade with a country whose economy is under comprehensive State guidance and control, there still exists a number of U.S. statutory and administrative measures which place on commercial relations with the PRC restrictions that do not apply to the U.S. trade with most of its other trading partners.

The purpose of this paper is to identify and briefly describe the existing statutory and regulatory measures that restrict or otherwise encumber commercial relations between the United States and Communist countries in general, and their present, often more liberal, application to China in the areas of U.S. imports, U.S. exports, U.S. investment abroad, third-country trade, and shipping. The last part of the paper gives a brief indication of the kinds of action that were or still would be needed to overcome or eliminate these obstacles to the extent that "normalization" is desired.

I. U.S. IMPORTS

A. Ban on Imports of Furskins

Since September 1, 1951, the United States has had in force a total ban on the importation of ermine, fox, kolinsky, marten, mink, muskrat, and weasel furskins from China. The ban was imposed under the provisions of sec. 11 of the Trade Agreements Extension Act of 1951 (65 Stat. 75) which required the President to prohibit the importation of such furskins from Communist China (and also from the Soviet Union).

As enacted, the provision was the conference version of a floor amendment approved by the Senate which would have, as a measure claimed to be for the protection of the U.S. furskin industry, limited the quantity of imports of mink, silver fox and muskrat furskins in any year to 25 percent of the domestic production of these furskins in the previous year. While the provision did not then specify any foreign country, it was aimed primarily against the Soviet Union, which in the late 1940s was the major source (20 to 30 percent) of U.S. furskins imports, while imports from China were significant but not large.

At present the provision banning furskin imports is part of the Tariff Schedules of the United States (19 U.S.C. 1202, Schedule 1. Part 5, Subpart B, Headnote 4). (See also footnote 28.)

B. Nondiscriminatory (Most-Favored-Nation) Treatment

In the same Trade Agreements Extension Act of 1951 that imposed the ban on furskin imports, the Congress, in sec. 5 (65 Stat. 73), directed the President to suspend the most-favored-nation (MFN) status of all countries of the Sino-Soviet bloc. The suspension took effect with respect to China on September 1, 1951, and for the Chinese-ruled Tibet in mid-1952. Subsequent legislation (sec. 231, Trade Expansion Act of 1962), moreover, made it impossible for China (and other Communist countries) to regain the MFN status without specific legislation.

This situation was changed somewhat by the Trade Act of 1974 (TA 74), which in Title IV made the restoration of the MFN status [1] to China possible, although subject to quite restrictive conditions. The Act (sec. 401; 19 U.S.C. 2431) continues the general U.S. policy of denying the MFN status to "nonmarket economy" (i.e., in practice, Communist) countries which did not enjoy such status at the time of the enactment of the 1974 Act. It does permit, however, under a rather complex set of provisions and conditions, the granting of the MFN status to such a country if its emigration policy is reasonably liberal. The basic conditions for granting the

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[1] In the House Report on the Trade Act (H. Rept. 93-571, p. 80), the MFN or nondiscriminatory treatment is defined, in effect, as one under which the concessionary (rather than full statutory) rates of customs duty are applied to imports from a country with the MFN status.

MFN status are spelled out in sec. 402 (the freedom-of-emigration or Jackson-Vanik amendment; 19 U.S.C. 2432) and several other related sections of the Trade Act.

As a "nonmarket economy" country, China was precluded from having its MFN status restored by the United States until the specific steps, required by law, were completed. These were:

1. *Bilateral agreement.*—On July 7, 1979, the United States and the PRC signed a bilateral commercial agreement [2] providing, among other things, for a mutual grant of the most-favored-nation treatment. As law requires, the agreement is limited to a three-year term (but is to be extended automatically for successive three-year terms unless denounced by either party); it contains provisions pertaining to the safeguarding of national security and protection of copyrights, patents, trademarks and industrial property; provides for mandatory consultations on bilateral trade problems and permits unilateral preventive or remedial action if consultations are unproductive; provides for consultation, conciliation and arbitration of disputes.

2. *Presidential proclamation.*—On October 23, 1979, President Carter issued a proclamation (No. 4697) of the agreement and of the extension of the MFN status to the PRC, with its entry into force delayed until the date on which the two parties have exchanged notices that the legal procedures required for the implementation of the agreement have been completed.

3. *Compliance with the freedom-of-emigration requirement.*—For all practical purposes, this is the crucial step in the process of restoring the MFN status to a Communist country. The freedom-of-emigration provision (Jackson-Vanik amendment) of the Trade Act requires, in effect, that emigration from the prospective recipient of the MFN status be at least substantially free of restrictions or fees.[3] The law provides for two alternative procedures of compliance with this requirement.

(a) The primary procedure, contained in the original Jackson-Vanik amendment, permits the concluding of a commercial agreement and the extension of the MFN status only after the President has submitted to the Congress a report indicating that the country in question is not in violation of the criteria of free emigration established in the freedom-of-emigration provision. The President is also directed to submit to the Congress similar semiannual reports (June 30 and December 31) as long as the agreement, extending the MFN status, remains in effect. Since the basic condition of this procedure is that there be no violation of the freedom-of-emigration requirements, the potential for using this procedure is severely limited. In fact, no attempt has been made thus far to follow this avenue to the restoration of the MFN status to a Communist Country.

(b) Somewhat less demanding are the requirements of the alternative approach to the MFN status, added to the freedom-of-emigration statute as a result of a compromise between the Congress and the Administration. The compromise provision authorizes the President, in extending the MFN status to any country, to waive by Executive order the primary requirement of no violation if he determines and reports to the Congress that such waiver will substantially promote the objectives of the freedom-of-emigration provision and that he has received assurances from the foreign country that its emigration practices will lead substantially to the achievement of the objectives of the statute.[4]

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[2] Agreement on trade relations between the United States of America and the People's Republic of China. Signed at Beijing July 7, 1979, entered into force February 1, 1980. TIAS 9630. 31 UST 4651.

[3] The more specific provision in respect to freedom-of-emigration to join a close relative in the United States (sec. 409 of the Act; 19 U.S.C. 2439) contains identical provisions as the general freedom-of-emigration provision (sec. 402) and is, in effect, a duplication of the latter.

A waiver of the primary freedom-of-emigration requirement was issued by the President with respect to China in Executive Order 12167 of October 23, 1979, after his waiver authority had been extended for a year, effective July 3, 1979.

4. Transmission to the Congress.—The President is specifically required by law to transmit to the Congress the following documents related to the granting of the MFN status:

(a) the bilateral commercial agreement, containing the extension of the MFN status and all provisions required by law (sec. 407(a); 19 U.S.C. 2437(a));

(b) the proclamation providing for the entry into force of the bilateral agreement; and

(c) the initial report indicating no violation of the freedom-of-emigration requirement, or the report of his waiving the requirement, containing or together with the determinations and the statement with respect to his having received assurances which are required by statute.

All these documents with respect to China were transmitted by the President in a communication to Congress on October 23, 1979.[5] The report on the waiver, however, neither enumerated nor even specifically mentioned the assurances that had been received from the PRC with respect to its future emigration practices; the President merely reported that he had "determined that the requirements of section 402(c)(2) (A) and (B) of the Act have been satisfied."[6]

5. Congressional approval.—A commercial agreement containing the grant of the MFN status and its implementing proclamation may take effect only if the Congress adopts a concurrent resolution of approval under the procedure specifically provided for by law (sec. 405(c); TA 74; 19 U.S.C. 2435(c)). That approval statute (sec. 151, TA 74; 19 U.S.C. 2191) mandates the introduction of the resolution, prescribes its language, prohibits any debates or amendments thereto, and sets up mandatory deadlines for its various legislative stages. Consequently, if either House wishes to disapprove the grant of the MFN status, it must do so by voting against it; the resolution cannot simply die for lack of legislative action.

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[4] The authority to waive the freedom-of-emigration requirement may be extended annually if the President determines that further extensions of the waiver authority will substantially promote the objectives of the freedom-of-emigration statute, recommends to the Congress, no later than 30 days before the expiration of the authority, that the authority be extended and sets forth his reasons for the recommendation. The determination must be made and the reasons for it explained in respect to every country for which a waiver is in effect as well as in respect to the general authority to waive. The annual extension of the waiver authority is automatic unless either House adopts within 60 calendar days after the end of the previous authority year and under procedure provided for in sec. 153 of the Act (19 U.S.C. 2193), a resolution disapproving the extension of the waiver authority either generally or with respect to any particular country.

[5] Agreement on trade relations between the United States and the People's Republic of China; communication from the President of the United States . . . Washington, U.S. Govt. Print. Off., 1979. (96th Congress, 1st session. House Doc. No. 96-209).

[6] Ibid., p. 11.

Moreover, implicit approval is required for the primary procedure of compliance with the freedom-of-emigration requirement. The initial Presidential report to Congress, indicating no violation of the requirement (see 3(a) above), may be disapproved (and the grant of the MFN status thereby nullified) if either House within 90 session days adopts a resolution of disapproval under the special procedures provided for by sec. 152 of the Act of the Act (19 U.S.C. 2192; prescribed language, prohibition of debate or amendments, mandatory legislative deadlines).[7]

The initial use of the waiver in respect to an individual country, on the other hand, requires no explicit or implicit Congressional approval. Congressional disapproval of any particular waiver at the time the waiver is first issued can be exercised only indirectly (except, of course, by passing a specific law to revoke the waiver) through failure to adopt the concurrent resolution required for the approval of the bilateral agreement. Under the existing statutory procedure, any waiver can be revoked directly only by means of a disapproval resolution adopted by either House (one-House veto) at the time of the annual extension of the waiver authority (see footnote 4).

A concurrent resolution to approve the extension of nondiscriminatory treatment to the People's Republic of China was introduced in the House on October 23, 1979, the same day on which the President transmitted his communication to Congress, and one in the Senate on the following day. Both resolutions were reported favorably by the respective Committees, although in the House report eight Members strongly objected to granting the MFN status to China on several grounds, among them the inadequacy of the President's report on free-emigration assurances received from China. Despite these objections and identical ones raised on the floor of the Senate, the concurrent resolution (H. Con. Res. 204) was approved by large majorities of both Houses, thus opening the way to the extension of the MFN treatment to the PRC.

6. Exchange of notices.—The grant of the MFN status as a rule becomes effective on the date on which written notices of acceptance are exchanged between the two countries. (See footnote 2 above.) Such exchange took place in Beijing on February 1, 1980, thus putting into force the trade agreement between the United States and the People's Republic of China and the mutual grant of the MFN status which it contains.

C. Generalized System of Preferences

Under its generalized system of preferences (GSP), provided for in Title V of the Trade Act of 1974 and in effect since January 1, 1976, the United States permits, for a 10-year period, duty-free importation of a wide array of products from eligible less developed countries (LDCs) designated as "beneficiary developing countries" (BDCs). Certain countries are barred from participation in the GSP for a variety of reasons.

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[7] A similar legislative veto (resulting in the termination of the MFN status of individual countries) can be exercised annually, with respect to the President's December no-violation reports on individual countries. The statute requires that such reports be submitted semiannually (see 3(a) above) if the MFN treatment, granted under the primary freedom-of-emigration procedure, is to continue. As mentioned earlier, no country at present enjoys the MFN status on the basis on this procedure, and the reports in question are not being submitted to the Congress.

Individually excluded, for instance, are presumed developing countries (sec. 502(b); 19 U.S.C. 2462(b)). China, however, is not listed among them. In fact, Article II of the trade agreement between the United States and the PRC specifically provides "that, at its current state of economic development, China is a developing country," thus making the PRC potentially eligible for the benefits of the U.S. generalized system of preferences.

The law, however, prohibits the designation of any Communist country as a BDC unless the country (a) has been granted the MFN status by the United States, (b) is a signatory of the General Agreement on Tariffs and Trade and a member of the International Monetary Fund, and (c) is not dominated or controlled by international communism. China fulfills most of these conditions but is not a signatory of the GATT and, hence, does not qualify for being designated a BDC under the U.S. generalized system of preferences.[8]

The PRC has indicated its desire to be designated as a beneficiary developing country under the U.S. GSP as soon as it fulfills all of these conditions. The U.S. International Trade Commission has conducted, at the request of the President transmitted through the U.S. Trade Representative, an investigation on "Probable economic effect on domestic industries of the designation of the Peoples Republic of China as a beneficiary developing country for purposes of the U.S. generalized system of preferences" (Investigation No. 332-123) and published a report thereon in June 1981.

D. Actions to Remedy Adverse Effect of Imports

Most actions available in law to U.S. industry for the purpose of remedying or counteracting any adverse effect of imports from China apply equally to China (as a Communist country) and to non-Communist countries. In some instances, however, the remedial measure may be, either in law or in practice, somewhat more readily applied to a Communist than to a non-Communist country. There are also some statutory remedies that can be used exclusively against Communist countries, including China.

1. Market Disruption.—Section 406 of the Trade Act of 1974 (19 U.S.C. 2436) establishes a special procedure to prevent or remedy the disruption of the U.S. market by imports of an article specifically from Communist countries.

While the general purpose of this procedure is the same as that of the escape clause procedure (protection of domestic producers against injury caused by increasing imports) and their mechanics are generally identical, the two procedures differ in several significant aspects, all of which tend to make the market disruption procedure less favorable to imports than the escape clause procedure. Market disruption investigation by the U.S. International Trade

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[8] China already is a beneficiary country under the GSPs of several other industrialized countries or entities, such as Canada, the European Communities (with some limitations as to products involved), Switzerland, Japan, Australia.

Commission can be initiated and the eventual remedy applied by the President with respect to only the specific country or countries where the disrupting imports originate while, in escape clause cases, imports of the article in question from all sources, or at least all major sources, are considered, and the remedial action, as a rule, is applied on a nondiscriminatory basis to all countries.[9] The causal connection between imports and injury, and the criterion of injury itself, underlying the USITC's recommendation for remedial action, are less strict in market disruption cases ("significant cause of material injury") than in escape clause cases ("substantial cause of serious injury"), with the consequence that injury finding is more likely in market disruption cases.

In market disruption cases, the USITC's investigation must be completed in 3 months (vs. 6 months under the escape clause procedure), and an orderly marketing agreement, if such course of action is decided, must be entered into within 60 days (vs. 90 days in escape clause actions). In addition, the President may take emergency import relief action before the USITC completes its investigation if he considers it necessary; such emergency action is not provided for in escape clause statutes.

Section 406, consequently, provides for an action to remedy import injury whose implementation is easier, faster and more specific than that of the escape clause procedure. The action is also discriminatory in that it applies only to imports from Communist countries.

The remedial procedure provided by this statute has been used with respect to China on four occasions. The very first case filed with the Commission under sec. 406 (in December 1977) involved certain types of cotton gloves imported from China. In this instance, the Commission found that the imports in question were not causing market disruption in the United States.[10] In the second investigation, filed in May 1978, China was one of three Communist countries whose exports of clothespins to the United States were allegedly causing market disruption. The USITC found that while imports from the other two countries (Poland and Romania) did not disrupt the U.S. market, those from China did.[11] The President, however, declined to take any remedial action against China since the Commission had in the meantime begun an escape clause investigation of imports of clothespins from all sources, 73 percent of which were accounted for by other foreign sources.[12]

The third sec. 406 investigation involving the PRC was instituted in May 1982 with respect to ceramic kitchenware and tableware. In it, the Commission determined that the imports in question caused no market disruption. In the most recent case, instituted in June 1982 and involving canned mushrooms from the PRC, the Commission's determination was evenly divided, leaving the final determination up to the President, whose action is still pending.

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[9] Although escape clause procedure of the Trade Act of 1974 does permit discriminatory application of remedies "but only after consideration of the relation of such actions to the international obligations of the United States" (sec. 203(k); 19 U.S.C. 2253(k)), import relief action has in practice always been applied in a nondiscriminatory manner.

[10] U.S. International Trade Commission. Certain gloves from the People's Republic of China; report to the President on investigation No. TA-406-1 under section 406 of the Trade Act of 1974. USITC Publication 867). Washington, March 1978.

[11] U.S. International Trade Commission. Clothespins from the People's Republic of China, the Polish People's Republic, and the Socialist Republic of Romania; report to the President on investigations Nos. TA-406-2, TA-406-3, and TA-406-4 under section 406 of the Trade Act of 1974. (USITC Publication 902). Washington, August 1978.

[12] Domestic clothespin industry; message to the Congress transmitting a report. October 2, 1978. Weekly compilation of Presidential documents, v. 14, No. 40. October 9, 1978, p. 1698.

2. Mandatory Safeguards Clause in Bilateral Agreements.—Apart from the discriminatory nature of the fact itself that a relative liberalization of trade relations with a Communist country (primarily, the granting of the MFN status) cannot take place without the entry into force of a bilateral agreement, such agreement, by law, must also contain a safeguards clause providing for mandatory consultations and authorizing the unilateral imposition of import restrictions in the event of actual or threatened market disruption. As mentioned earlier (see B.1. above), such a safeguards clause is included in the trade agreement between the United States and the PRC.

3. Antidumping Action.—China is subject to the possible use of a special provision of the antidumping law (sec. 773(c) of the Tariff Act of 1930, as added by the Trade Agreements Act of 1979; 19 U.S.C. 1677b(c))—first enacted in 1975—which calls for an alternative method of determining the foreign market value of imports from state-controlled economies that are suspected of being dumped on the U.S. market. Foreign market value is one of the components used to establish whether an imported commodity is being sold in the United States at less than fair value [13] and to determine the level of the antidumping duty in the event that dumping has been determined to have taken place.

Generally, foreign market value is the price at which an imported commodity is sold in the country of origin or, alternatively, in third countries to which it is being exported. If, however, the economy of the exporting country is state-controlled to the extent that domestic or third-country market export prices do not permit a determination of foreign market value in the normal manner, foreign market value must be determined on the basis of the price at which similar merchandise produced in a surrogate "non-State-controlled-economy country" is sold either domestically or in third countries, or, alternatively, on the basis of the constructed value of similar merchandise of the surrogate. The method for calculating the constructed value is prescribed by law and contains mandatory minimal levels for certain cost components (general expenses, profit); it can, therefore, result in a value higher than the value based on actual cost of production. Such course of action may work to the disadvantage of the exporting country if the country is, in fact, the least-cost foreign producer of the article in question, for it may result in a higher antidumping duty than would normally be the case or even in the levying of an antidumping duty where none would be called for.

Antidumping investigations involving products from Communist countries initiated since the enactment of this provision, in general, have been few, and in only three instances, thus far, imports from the PRC have been subjected to the antidumping procedure. In June 1980, a petition was filed alleging injurious dumping of menthol originating in China. During the process, the International Trade Administration of the U.S. Department of Commerce determined that the PRC was a State-controlled-economy country within the meaning of the law and, as of May 1, 1981, also that, based on the foreign market value of menthol in Paraguay (determined as being the appropriate surrogate country), sales at less than fair value were taking place. The USITC, however, determined on June 1, 1981, that these imports caused neither injury nor retardation of a U.S. industry, and antidumping duty was not assessed.

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[13] A determination of the existence of sales at less than fair value is one essential element for a finding of dumping and assessment of antidumping duty. The other essential element is a determination by the U.S. International Trade Commission that an industry in the United States is materially injured or threatened with material injury, or the establishment of an industry in the United States is materially retarded by reason of the imports in question.

Two recent antidumping cases, begun in August 1982 and involving greige polyester/cotton printcloth and shop towels of cotton, are still pending. In both, the USITC has made a preliminary affirmative determination of reasonable indication of injury to a U.S. industry, while further relevant determinations still remain to be made.

4. Countervailing Action.—Whenever a foreign country subsidizes the production or exportation of an article, the United States may counteract the competitive advantage that the import has in the U.S. market because of the subsidy by levying a countervailing duty, equal to the amount of the subsidy. Amendments of the countervailing statute, enacted in the Trade Agreements Act of 1979, provided for different applicability of the countervailing duty, depending on whether or not the subsidizing country is a "country under the Agreement" as defined by law.[14] Under the new law, countervailing duty may be levied on subsidized imports from a country under the Agreement only if it is also determined that they are actually causing, or threatening to cause, injury to a U.S. domestic industry (Title VII, Subtitle A, Tariff Act of 1930, added by the Trade Agreements Act of 1979 (19 U.S.C. 1671–1671f)). Subsidized imports from countries not under the Agreement are countervailed under the old countervailing law (19 U.S.C. 1303) and do not have to meet the injury test.

This differentiation places China in the less favorable of the two categories. Since the PRC is not a country under the Agreement (neither are any other Communist countries nor many non-Communist ones) countervailing duties would apply to imports from China merely on the strength of a determination that its exports are being subsidized and countervailing duty would be assessed even though they would not be causing injury to, or threatening with injury, any U.S. industry.

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[14] The law defines a "country under the Agreement" as a country (1) which is a signatory of the Agreement on Subsidies and Countervailing, concluded in the multilateral trade negotiations of the Tokyo Round, or (2) which has assumed obligations substantially equivalent to those under the Agreement, or (3) which is not a party to GATT but has in force a bilateral agreement with the United States, providing for unconditional MFN treatment (sec. 701(b) of the Tariff Act of 1930, as added by sec. 101 of the Trade Agreements Act of 1979; 19 U.S.C. 1761(b)).

II. U.S. EXPORTS

A. Export Controls

The system of U.S. export controls has since World War II developed into an important tool of foreign economic policy, aimed primarily at preventing the flow of strategic and high-technology products and technical data of U.S. origin to Communist countries. While the broad guidelines for controlling exports have been set by statute, their detailed and specific implementation has mostly been left to administrative regulatory action, which is more flexible and adaptable to practical exigencies of a diverse and ever changing situation. Consequently, a system of export controls has gradually emerged in which there are differences in U.S. treatment not only of Communist as compared to non-Communist countries but also of countries within the Communist group itself.

1. The bulk of U.S. exports of goods and technical data is controlled by the U.S. Office of Export Administration under the authority of the Export Administration Act of 1979 (50 U.S.C. App. 2401 et seq.), implemented through Export Administration Regulations (15 C.F.R. 368-399.2). It is through these regulations that a specific level of restrictiveness is applied to exports to any destination in the world. There are basically three levels of restrictiveness as characterized by the range of commodities that require individual "validated" licenses for exportation to countries at that level and by the purpose of controls: (1) the level at which virtually all exports require validated license, which, as a rule, is not issued, the result being a virtually total export embargo; (2) the level at which validated license is required only for strategic or high-technology exports, and may be issued if the intended use of the export is judged not to endanger U.S. national security; and (3) the level at which validated license is required for strategic or high-technology exports, primarily for the purpose of preventing reexportation of the item to destinations in the other two categories, and is usually readily issued, if control over reexportation is assured. Exports that do not require a validated license take place under a general license (a blanket permission to export), usually under general license G-DEST.

Most commodities that require a validated license for export to countries at level (2) and virtually all of those requiring a validated license for export to countries at level (3) are articles whose exportation is controlled also internationally by the Coordinating Committee (COCOM), consisting at present of all NATO countries (except Iceland) and Japan.[15]

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[15] The original statutory authority for U.S. participation in COCOM (Mutual Defense Assistance Control Act of 1951—"Battle Act") was terminated by sec. 17(e) of the Export Administration Act of 1979 (50 U.S.C. App. 2461(e); the present authority is contained in sec. 5(k) of EAA 79 (50 U.S.C. App. 2404(k).

During the Korean War, a special China Committee (CHINCOM) was set up in September 1952 by COCOM members to administer international controls of exports to China. These controls were more extensive (included about 200 more items) than those on exports to the Soviet Bloc ("China differential"). In late 1955 (two years after the Korean armistice was signed), some COCOM-CHINCOM members began questioning the need for the China differential and gradually unilaterally relaxed some of its controls. After a May 1957 meeting on the subject failed to reconcile the divergent views on the modification of the China embargo, several countries unilaterally eliminated the China differential and CHINCOM ceased to exist. The United States, opposed to any relaxation of the international embargo, thereafter continued to maintain it unilaterally.

For purposes of more detailed control, the countries of the world (except Canada) are assigned to specific "country groups" of which one or more are placed at one of the three general levels of restrictiveness. Shortly after the lifting of the embargo on trade with China in 1971 (prior to which China was at the most restrictive level in country group Z, together with Cuba, North Korea and North Vietnam), the PRC was placed in country group Y at the middle level, the level to which also belong all the countries of the Warsaw Pact. Changes in the export control policy since that time as well as the gradual improvement in U.S. commercial relations with China resulted in transfering, as of April 25, 1980, the PRC to a country group of its own (Group P), still at the same level of restrictiveness, but allowing some differentiation in favor of China.[16]

The removal of China from Group Y and its transfer to a separate group of its own was prompted by the consideration that, in the case of China, factors relevant for the determination as to which exports would contribute significantly to military potential of the country in question are different from those that would come into play with respect to Warsaw Pact countries. Although China is in a separate country group, exports to China are at present still subject to the same formal validated license requirements as those to Warsaw Pact countries;[17] there has been however, some liberalization of the guidelines which the Office of Export Administration uses in the approval process for validated licenses for exports to China of products and technical data controlled on national security grounds, particularly of the so-called "dual-use" products.

2. Exports of military articles are controlled under the authority of sec. 38 of the Arms Export Control Act (22 U.S.C. 2778), which authorizes the President to control all trade in defense articles and services. Exports of any arms, ammunition and implements of war listed in the U.S. Munitions List (22 C.F.R. 121.10), and of related technical data generally require a specific license issued by the U.S. Office of Munitions Control of the U.S. Department of State in coordination with the U.S. Arms Control and Disarmament Agency. While such license may be denied for any of the several reasons stated in the regulations with respect to exports to any country, the policy of the United States also is to deny any licenses for exports of U.S. Munitions List articles to any Communist country except Yugoslavia.

This policy was modified with respect to the People's Republic of China in January 1980 when certain categories of military support (i.e. non-lethal) equipment included in the U.S. Munitions List were made eligible for sale to China and licensable for export on a case-by-case basis.

3. Exports of nuclear materials are controlled by the Nuclear Regulatory Commission under the authority of the Atomic Energy Act of 1954, as amended (42 U.S.C. 2011-2282). Virtually all nuclear exports to any destination require a license. Certain nuclear materials, however, may be exported under general license, provided

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[16] A similar transfer to a country group of its own, much for the same reasons as in the case of China, took place earlier with respect to Poland (later joined by Hungary) (Group W) and Romania (Group Q).

[17] 45 F.R. 27922 (April 25, 1980).

that such exportation will not be inimical to the common defense and security or constitute an unreasonable risk to the public health and safety. Prior to a March 1980 revision of nuclear export regulations, only very few nuclear materials that were exportable under general licenses to non-Communist countries could be exported under the same type of license also to some Communist countries. In addition, general license applicability varied among Communist countries themselves, China being in the group of the most restricted destinations short of complete embargo. Since the revision, virtually all general licenses have applied also to exports to Communist countries, including the PRC, with the exception of the embargoed ones (Cuba, Kampuchea, North Korea, and Vietnam) (10 C.F.R. 110-20—110.28).

B. Export Credit Operations

Most Communist countries at present have no access to U.S. Government export credit facilities and—to the extent that in practice private export credit functionally depends on U.S. Government insurance or guarantees—only limited access to private U.S. sources of export financing. The basic obstacle is raised by the provisions of sec. 402 of the Trade Act of 1974 (19 U.S.C. 2432) which prohibit the participation of Communist countries in any credit operations of the U.S. Government unless the same freedom-of-emigration requirements that apply to the extension of the most-favored-nation status (see Part I.B. above) are met. Consequently, a Communist country can participate in U.S. credit operations only if it places no restrictions on emigration, or if its restrictions are sufficiently mild to enable it to qualify for the required Presidential waiver. Although a country's participation in U.S. Government credit programs is not legally contingent on its having been granted the MFN status, the two benefits go hand in hand because they are subject to the same explicit or at least implicit approval procedure.[18]

Since the People's Republic of China has been granted a Presidential waiver of the Jackson-Vanik requirement (see I.B.3. above), this, the principal and most serious obstacle to China's participation in U.S. Government's export credit programs has been removed.[19]

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[18] There is technically a slight difference between the MFN and the credit approval procedure in that, in waiver cases, no action by Congress is necessary for a country's eligibility for credit once the waiver is issued. From a practical standpoint, however, it is not likely that credit facilities would, in fact, be extended to a country to which the MFN status has been denied by a vote of Congress, and the waiver in question would certainly be revoked by Congress at the time of the next annual extension of the waiver authority, if not sooner rescinded by the President himself.

[19] Access of some Communist countries to American private export credits is affected—although probably not severely—by the restrictions of the Johnson Debt Default Act (18 U.S.C. 955), since they are in default on debts to the U.S. Government and do not meet the conditions of statutory exceptions. Although the United States has been trying to get the PRC to assume the obligation to repay the portion of several Eximbank loans, originally extended to the Nationalist Government, commensurate with the value of the equipment, financed by such loans, that remained on the mainland after the Communist takeover—an obligation the PRC refuses to accept as its own—China is not considered in default to the United States, hence the restrictions of the Johnson Debt Default Act do not apply.

1. EXPORT-IMPORT BANK OF THE UNITED STATES

The Export-Import Bank of the United States (Eximbank) provides direct export credits and various types of insurance and guarantees of export credits extended by private financial firms. Its activities with respect to exports to most Communist countries are severely restricted by law, a fact which significantly hinders the potential growth of U.S. exports to the countries to which the restrictions apply.

In addition to the general restriction on export credits mandated by the freedom-of-emigration provisions of the Trade Act of 1974, Eximbank's credit transactions with Communist countries are also subject to specific restrictions, contained in the Eximbank's organic act itself. The Export-Import Bank Act of 1945, as amended, in sec. 2(b)(2) (12 U.S.C. 635(b)(2)) prohibits any credit activities of the Bank related to direct or indirect exports to any Communist country unless the President determines that such credit transactions would be in the national interest.[20] Moreover, every such transaction involving a Bank's loan of $50 million or more requires a separate Presidential determination of national interest. All determinations must be reported to Congress.

Once the Jackson-Vanik obstacle to China's access to Eximbank facilities was removed through the waiver procedure, China still remained subject to the specific restriction contained in the Export-Import Bank Act. This was easily overcome by a Presidential determination, signed on April 2, 1980, that the Eximbank's financing of exports to the PRC would be in the national interest.[21]

The overall operating procedure for Eximbank's extension of export credits to China, handled on the Chinese side exclusively by the Bank of China, was established jointly during talks between the two sides held in Washington in June 1980. Applications for credits are being considered by the Eximbank on a case-by-case basis as they are submitted. Three loans, totaling $125.5 million, have thus far been authorized to the PRC.

2. COMMODITY CREDIT CORPORATION

Financing of sales of agricultural commodities to Communist countries under CCC programs is subject only to the restrictions of the freedom-of-emigration requirement. In the case of China, some access to CCC financed exports was authorized even before the Jackson-Vanik restriction was eliminated. Sec. 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 1707c), enacted on October 21, 1978, authorized the CCC to "provide financing for commercial sales of agricultural commodities out of private stocks on terms of not to exceed three years to the People's Republic of China under (1) the short-term export credit sales program conducted by the Corporation, and (2) the deferred payment sales program for exporters established under section 201 * * *"

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[20] This restriction, in effect since 1963, however, has not represented a serious obstacle to the Eximbank's financing of exports to Communist countries, since the President's determinations of national interest have been readily made.

[21] Presidential Determination No. 80-15, 45 F.R. 26017 (April 17, 1980).

Since this law permitted the PRC to use short-term (up to three years) CCC financing under two programs, China was obviously not yet given access to the full range of the CCC's credit sales programs (e.g., to intermediate credit sales). This limitation was eliminated with the Presidential waiver of the Jackson-Vanik requirement. China, however, has as yet not availed itself of CCC-financed credit sales.

III. U.S. FOREIGN DIRECT INVESTMENT

On August 8, 1979, the People's Republic of China promulgated a Joint Venture Law, which opened the way for the participation of foreign firms in the Chinese economy, particularly with technology, capital equipment, foreign marketing know-how, and management expertise. While the law provides only the general outline of the legal status of joint ventures and leaves much ground to be covered in individual joint venture agreements—a tedious and possibly frustrating process—it has engendered some interest, if perhaps little outright enthusiasm, in potential foreign, including American, investors.

To the extent that American investors are willing to commit their capital to joint ventures in China, such investments are much more likely to take place if they can be covered by investment guaranties and insurance and supported by other services provided by the Overseas Private Investment Corporation (OPIC).

OPIC was created by Title IV of the Foreign Assistance Act of 1961 (FAA 61), as added by the Foreign Assistance Act of 1969 (FAA 69) (22 U.S.C. 2191-2200a), as a Federal agency charged with the task of encouraging and supporting U.S. private investment in less developed friendly countries. Its activities encompass assistance in finding investment opportunities abroad, underwriting investment insurance and guaranties, and extending loans and loan guaranties to help finance foreign investment. Before the insurance or guaranty program can be implemented in a foreign country, a bilateral agreement must be concluded with the country in question, in which the guidelines and conditions of the program (including provisions for compensation of covered investment losses) are spelled out.

OPIC's operations in Communist countries, however, are subject to several restrictions. The most pervasive and basic is the freedom-of-emigration ban of the Trade Act of 1974, which places OPIC's operations in the same position as export credit operations (see Part II.B): unless the conditions of the Jackson-Vanik statute are met, investment guaranties or loans cannot be extended.

The Jackson-Vanik obstacle to OPIC's providing its services to American investors in the Chinese economy was eliminated by the Presidential waiver issued during the process of bringing into effect the U.S.-PRC commercial agreement and China's MFN status (see Part I.B.3. above).

A further obstacle that was still to be surmounted with respect to allowing OPIC's operations in China is the general prohibition of extending assistance to any Communist country, contained in sec. 620(f) of the Foreign Assistance Act of 1961 (FAA 61), as amended (22 U.S.C. 2370(f)). The prohibition affects OPIC activities in China by virtue of the fact that OPIC legislation is part of the Foreign Assistance Act of 1961, to which the prohibition applies, and that it specifically lists "Peoples [sic] Republic of China" as a Communist country. This restriction may be waived, however, if "the President finds and reports to Congress that (1) such assistance is vital to the security of the United States, (2) the recipient country is not controlled by the international Communist conspiracy, and (3) such assistance will further promote the independence of the recipient country from international communism."

Since this waiver provision is somewhat cumbersome—and, in the case of China, a waiver possibly somewhat hard to justify—it was by-passed and a specific statute was enacted instead. The law extended to the PRC the applicability of a provision, enacted in 1972, which has permitted the operation of OPIC programs in Romania and Yugoslavia, if the President determines it to be important to the national interest (sec. 239(g), FAA 61, as amended; 22 U.S.C. 2199(g)). President Carter signed the law (P.L. 96-327; 94 Stat. 1026) and the determination of national interest on August 8, 1980.[22]

Other practical considerations of general nature in connection with the extension of OPIC's programs to American investments in China created no problems. The applicability of OPIC's activities solely to "less developed countries" had already been taken care of with respect to China since in the trade agreement China was officially recognized by the United States as a "developing country" (see Part I.C. above).

In addition, OPIC may operate only in "friendly" countries. "Friendly" countries are nowhere defined in the FAA 61, but the term itself is used, in other legislation, in the context of Communist vs. non-Communist countries. A functional decision in this matter must be made internally by OPIC itself on a case-by-case basis. It was obviously made in favor of China.[23]

The bilateral investment guaranty agreement, required by law, was signed with China and entered into force on October 30, 1980, upon an exchange of notes in Beijing.[24] Since that time, OPIC has underwritten insurance on several American projects in China.

IV. CONTROL OF THIRD COUNTRIES' TRADE WITH CHINA

In certain instances, the United States also maintains control over exports of goods or technical data from third countries. Such control is exercised over reexports of goods or data originally exported from the United States, over exports of articles containing components or technology of U.S. origin, and over internationally controlled products exported from a third country by a firm owned or controlled by a U.S. entity. These controls apply in addition to—and sometimes in conflict with—any export controls that may be exercised by the authorities of the exporting country itself.

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[22] Presidential Determination No. 80-25, 45 F.R. 54299 (August 15, 1980).

[23] In its decision to treat China as a "friendly" country, OPIC may have relied also on the fact that the PRC had been determined to be a "friendly country" for the purpose of sec. 607a of the FAA 61, thus allowing U.S. Government agencies to furnish services and commodities to China on reimbursement basis.

[24] Agreement relating to investment guaranties, with related notes and statement. Exchange of notes at Beijing October 30, 1980; entered into force October 30, 1980. TIAS 9924.

A. Reexports

Under the authority of the Export Adminstration Act, Export Administration Regulations (15 C.F.R. 374) place virtually identical restrictions and licensing requirements on the reexportation from a foreign country of articles originally exported from the United States as they do on direct exports from the United States. Consequently, reexports of U.S.-origin commodities from third countries to China must take place essentially under the same type of license, issued by the Office of Export Administration, as would be required for direct exports of the same commodity from the United States (see Part II.A.1).

B. Exports Containing U.S.-Origin Parts or Materials

The incorporation of U.S.-origin components, parts, or other materials into products made abroad and intended for exportation to third countries is subject in certain instances to prior approval of the Office of Export Administration (15 C.F.R. 376.12). Such incorporation into a foreign-made end-product to be exported to the People's Republic of China may not take place without prior U.S. approval when the final product or in most instances in which the part or component itself could not be exported to China from the United States under general license G–DEST (that is, would normally require a validated export license).

C. Reexports of U.S. Technical Data

Under the provisions of 15 C.F.R. 379.8, U.S. controls on reexports of U.S.-origin technical data by third countries apply to two basic forms of data exportation: reexport of technical data as such, and export of products manufactured abroad by use of U.S. technical data.

Controls over the second type of data are in effect only with respect to reexports to China (and other Communist countries except Yugoslavia). Such controls apply principally to an array of highly sophisticated products with strategic implications that are specifically listed in relevant export administration regulations. They also apply to articles produced by any plant or major component thereof that is a direct product of U.S. technical data and included in the list.

D. Exports by Foreign Subsidiaries of U.S. Firms

The United States also exercises controls over certain exports by foreign entities owned or controlled by U.S.-resident individuals or firms. This control mechanism functions in practice as an extension of the international COCOM export controls (see Part II.A.1). American-owned or -controlled foreign firms are prohibited from exporting directly or indirectly to any Communist country, except Yugoslavia, without a U.S. license any article subject to COCOM controls (high-technology items, munitions, nuclear materials). Exports made from and licensed by a member country of the COCOM to a Communist country other than Cambodia, North Korea, or Vietnam (hence, to China) are exempt from this restriction. In contrast to most export controls, these controls are administered by the Office of Foreign Assets Control of the U.S. Department of the Treasury under the provisions of 31 C.F.R. 505 (Transaction Control Regulations), promulgated under the erstwhile authority of sec. 5(b) of the Trading With the Enemy Act (50 U.S.C. App. 5(b)).[25]

In practice, then, these restrictions apply to exports to China of COCOM-controlled articles by subsidiaries of U.S. firms from countries that are not members of COCOM.

V. Shipping Controls

Unilateral as well as COCOM international controls on exports to most Communist countries are backed up by U.S. controls on U.S.-flag shipping, implemented through Transportation Order T-1 (44 C.F.R. 401), issued under the authority of secs. 101 and 704 of the Defense Production Act of 1950, as amended (50 U.S.C. App. 2071 and 2154). The order has been in force since December 8, 1950, and appears to badly need updating.[26]

It prohibits, under criminal penalties, any U.S.-flag ship or aircraft from carrying strategic or high-technology articles (all articles internationally or unilaterally—by the United States—controlled to all destinations, plus some others) directly or ultimately destined to any country falling into export control country groups X, Y, and Z,[27] unless the article has been issued a U.S. validated export license (in the case of a U.S.-origin article) or the shipment has been authorized by the International Trade Administration.

In practice, authorizations are not likely to be requested or needed. The exportation of the restricted articles from the United States, or if they contain U.S.-origin components or technology, from third countries, needs and is presumed to have a U.S. validated export license, hence, does not require a specific shipment authorization. Shipments of articles wholly of third-country origin—which would require a shipment authorization—however, are not likely to be carried in U.S.-flag ships or aircraft and hence are not likely to be subject to the provisions of the order.

Negligible as its impact on overall East-West trade has been, Transportation Order T-1 ceased applying to U.S. shipping in the export trade of third countries with the People's Republic of China when the latter was transferred from country group Y to group P. While this may theoretically be an anomaly, since other U.S. controls on exports to China are essentially the same as those on exports of group Y countries, it has no practical consequence for China.

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[25] Although the national emergency authority of the Trading With the Enemy Act, under which the Transaction Control Regulations were originally promulgated, has been repealed by sec. 101(a) of P.L. 95-223 of December 28, 1977, the exercise of authorities contained in those regulations has been continued until September 14, 1983, under sec. 101(b) of the same Act (50 U.S.C. App. 5 note) and Presidential Memorandum of September 8, 1982 (47 F.R. 39797).

[26] The order and its interpretations contain references to no longer existing statutes and regulatory provisions, and internal inconsistencies. Lack of updating in the past has—probably unintentionally—reduced its geographic applicability (see comments on group Y in footnote 27). In fact, the order is under review, has been characterized as non-significant regulation, and possibly will be eliminated (45 F.R. 71117).

[27] Country group X, once consisting of Hong Kong and Macao, was eliminated in August 1972; group Y, originally containing all Communist countries not subject to export embargo, has been gradually reduced by transfers of individual countries to separate country groups (e.g., Poland and Hungary to group W, Romania to Q, and China to P); group Z, the export embargo group, once containing also the PRC, now consists of Cuba, Kampuchea, North Korea, and Vietnam.

VI. NORMALIZATION OF RELATIONS

As has been suggested in the Introduction, normalization of commercial relations with the People's Republic of China means in the context of this paper merely the elimination of those discriminatory statutory or regulatory provisions that place special obstacles, restrictions, or requirements on trade with the PRC; it means, briefly, the action needed to place China on even footing with non-Communist countries as far as commercial relations are concerned. It is, furthermore, not the purpose of this brief consideration of normalizing action to assess the probability of or to present arguments either for or against such normalization, nor, indeed, to analyze the validity of and the reasons for the original placing of any special restriction or obstacle on these commercial relations.

Implicit in the foregoing description of the various obstacles to normal relations with China is the suggestion that these obstacles are the result of several types of implementing mandate. Some of them are required by law, others are set up by Executive regulation based on a special statutory authority (which in most practical instances amounts to an implicit legislative mandate), others again have been implemented through regulation based on a statutory authority of more general purpose or scope and clearly discretionary. Consequently, normalizing action need not in every instance be of the same type.

Obviously, all restrictions, regardless of whether explicitly or implicitly mandated or merely authorized by law, can be removed by legislative action. In view of the fact, however, that virtually all restrictions on commercial relations with China have applied to Communist countries in general rather than specifically to China, such legislative action cannot be in the form of a simple repeal as this would remove the restriction altogether and not only with respect to the PRC—the kind of selective normalization assumed by this paper.

A more realistic approach would consist of legislation specifically authorizing or mandating that China be exempted from the purview of the respective restriction. Most actions to normalize commercial relations with China—those that have already been taken and those that may still have to be implemented—fall within this category. The granting of the most-favored-nation status to China, for instance, in addition to being contingent on specific conditions, required legislative approval by means of a concurrent resolution. The Presidential waiver authority, which is one of the conditions for the removal of the Jackson-Vanik ban on China's MFN status and its use of U.S. Government credits and investment guaranties, itself depends on at least implicit annual Congressional approval (see footnote 4). China's use of certain CCC credit facilities was authorized by a specific statute (see Part II.B.2.) as was its participation in OPIC programs (see Part III).

With respect to restrictions still in force, several would require legislative action if across-the-board normalization is to take place: the ban on imports of furskins [28] (Part I.A.), the market disruption provisions of sec. 406 of the Trade Act of 1974 (Part I.D.1.), the mandatory inclusion of safeguards clauses in bilateral trade agreements (Part I.D.2.), and the alternative method of determining foreign market value of imports from State-controlled-economy countries in antidumping investigations (Part I.D.4.).

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[28] Legislation containing a repeal of the ban on imports of furskins from China (H.R. 6867) was approved by the House in late September 1982 and is still pending in the 97th Congress.

Mandatory—although waivable under certain conditions—and hence removable only by legislation are the bans on the participation of Communist countries in Eximbank programs (Part II.B.2.) and in OPIC programs (Part II.), and—under the Jackson-Vanik amendment—the freedom-of-emigration requirement in granting the most-favored-nation status to nonmarket economy countries (Part I.B.). Waiver was used for the benefit of China in the extension of the MFN status and of Eximbank's credit facilities, while the ban on participation in OPIC programs was removed by specific legislation.

In some instances, a certain degree of normalization can be achieved within the existing law by the PRC's meeting the statutory requirements or conditions underlying the normalizing action. Nevertheless, as long as these statutory conditions remain in effect and are applicable to China (and other Communist countries) but not to U.S. trading partners in general, one cannot consider that full normalization has taken place: first, because there would still exist a provision in theory discriminating against China, and second, because by failing to continue to meet the statutory conditions, China would be in practice subject to the reimposition of the restriction. In this category are the primary requirements and conditions of the Jackson-Vanik ban, and additional conditions for the designation of China as a beneficiary developing country under the generalized system of preferences (Part I.C.). The former were bypassed through the use of the waiver procedure; the latter are still in force and, in present circumstances, would have to be removed with respect to China by specific law.

Any restriction not mandated by law but implemented pursuant to a statutory authorization can, technically, be eliminated merely by Executive action. The Executive would, of course, have to remain guided by the legislative intent of the underlying statutory authority. When the legislative intent or policy would seem to go against it, some legislative modification of the intent or policy may also be called for before the Executive action is taken.

The system of export controls, for instance, is based on legislation that authorizes rather than mandates Executive action in this area; such controls could, technically, be mitigated or perhaps even removed by Executive action alone. Significant changes in the system as a whole have, in fact, been taking place all along within the existing statutory guidelines. Even more noteworthy in the context of normalization of the United States' trade with the PRC are the regulatory changes (e.g., transfer of China to export control country group P) and changes in licensing guidelines for exports of high-technology articles (Part II.A.1.) and military support equipment (Part II.A.3.) which apply exclusively to China.

Freedom of action by the Executive in this area is, nevertheless, significantly circumscribed in practice by the clearly stated Congressional intent and—especially in the context of the Export Administration Act—by Congressional findings, declarations of policy and, implicitly, administrative directives which the Congress has inserted into the legislation. Thus, while marked changes in the administration and especially mechanics of the export control system are possible and, indeed, have been made by Executive action alone, a total removal of controls applying specifically to exports to the People's Republic of China would appear, at this time at least, to go counter to existing policy guidelines and would for all practical purposes require Congressional sanction as well. A change in Congressional mood, expressed in new legislation, would almost inevitablly be called for if controls on direct U.S. exports to China were to be totally "normalized."

Exports from third countries of articles of U.S. origin, or of articles containing U.S.-origin components or technical data, would probably fall within the same category. Third-country exports over which the United States—often faced with the respective foreign Governments' serious annoyance at what they consider U.S. interference in an area of their sovereign competence—claims control only because they are produced by an American-owned foreign subsidiary or shipped on a U.S.-flag carrier, on the other hand, can probably be released from U.S. control by Executive action without serious disregard of Congressional intent, since the occasions for exercising this control authority are generally quite infrequent and, in the case of shipping controls, virtually nonexistent.

It is obvious that, regardless of how readily any normalizing action can be taken by the United States in theory, such action has in past practice depended and will continue to depend essentially on changes in the internal and, above all, external political situation of the PRC as they affect, or are perceived to affect, the national security and foreign policy interests of the United States, namely, those interests that originally induced the United States to put these restrictions into effect. This element, however, depends certainly no less on the flexibility of the People's Republic of China than on the goodwill of the United States.

U.S.-PRC TRADE NORMALIZATION: EFFECTS ON U.S. IMPORTS AND EMPLOYMENT

By Thomas Bayard, James Orr, Joseph Pelzman, and Jorge Perez-Lopez*

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I. Introduction

The process of normalization of economic and commercial relations between the United States and the People's Republic of China (PRC) began in earnest in early 1979 and has made significant progress in the last three years. During this period several bilateral agreements to remove legal obstacles to the development of the bilateral relationship have been concluded. Moreover, unilateral U.S. restrictions on economic relations with the PRC have been progressively relaxed. U.S.-PRC commercial ties have benefitted from the closer relationship between the two nations and the reduction or elimination of tariff and non-tariff barriers to trade.[1]

Using trade turnover as an indicator, the success of the U.S.-PRC normalization process is quite impressive. Trade turnover stood at $1.1 billion in 1978, it doubled to $2.3 billion in 1979 and doubled again to $4.8 billion in 1980. U.S. exports to the PRC have far outpaced imports, with the Chinese trade deficit growing from $424 million in 1978 to $1.1 billion in 1979 and $2.7 billion in 1980. These large Chinese trade deficits tend to obscure the impressive growth of U.S. imports from the PRC, which expanded from $324 million in 1978, to $592 million in 1979, and to slightly over $1 billion in 1980.

An evaluation of the impact on the United States of normalization of economic and commercial relations with the PRC is difficult, but it is certain to include both positive and negative factors. On the one hand, normalization creates a favorable climate for U.S. exports to the PRC to expand, and they have done so. Increases in exports have positive implications for the U.S. trade balance and employment in export-related industries. On the other hand, the favorable climate created by normalization also tends to encourage imports from the PRC. To the extent that they displace domestic production, increased import flows have a negative effect on U.S. production and employment, particularly if they are concentrated in certain sensitive domestic sectors. The net effect of normalization depends on the magnitude of the two trade flows and on their sectorial distribution.

This study analyzes the impact on U.S. imports and employment of normalization of relations between the United States and the PRC. In particular, the study estimates the impact on U.S. imports and employment of reducing tariffs on imports from the PRC as a result of granting most-favored-nation (MFN) tariff treatment to PRC goods and the possibility of further reducing some tariffs to zero under the U.S. Generalized System of Preferences (GSP). This was done, subject to several restrictive assumptions, by estimating the amount by which U.S. imports from the PRC would have exceeded their actual 1979 values had the PRC enjoyed MFN and

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[1] For a discussion of other countries' experiences with normalization of relations with the PRC, including effects on trade, see Committee on Foreign Affairs. Subcommittee on Asian and Pacific Affairs, Recognizing the People's Republic of China: The Experience of Japan, Australia, France, and West Germany (Washington: U.S. Government Printing Office, 1979).

GSP-eligible status during that year. Both aggregate and sectorial trade changes were estimated, and emphasis was placed on identifying specific sectors which may be particularly sensitive to increased imports. These trade changes were converted to changes in domestic output and employment.

Our analysis suggests that the aggregate effects of granting MFN or GSP status to the PRC are relatively small. If the PRC had received MFN status in 1979, U.S. imports from the PRC would have increased by $134 million, roughly a 25-percent increase, with a resulting loss of 8,600 job opportunities. These estimates do not take into account the impact of U.S. restraints on Chinese apparel imports. The restraints would limit the increase in imports from the PRC to about $70 million and the impact on employment opportunities to 3,700. The aggregate effects of granting GSP status are also small. U.S. imports would increase by about $14 million.

The aggregate trade and employment effects of U.S.-PRC normalization are relatively small because the volume of trade, although it is growing rapidly, is still quite small. However, the analysis also indicates that the increases in U.S. imports from the PRC are concentrated in a number of import-sensitive industries in which domestic production is highly labor-intensive and low-skilled. Increases in imports may impose substantial adjustment costs on these industries.

Moreover, it is important to recognize that the reduction in tariffs is only one of the factors responsible for increased imports from the PRC. As a result of PRC isolationist policies and U.S. constraints on dealing with the PRC, Chinese officials and U.S. businessmen were unable to meet and explore opportunities for trade between the two nations. As relations have normalized, and regulations on travel and the flow of information between the two countries eased, trade has been stimulated. These additional trade flows, which are independent of tariff reductions, are the result of what may be referred to as the "getting to know each other" effect. Although quantitatively this component of growth in imports may be more significant than that generated by the tariff reductions, it is not considered here since it is exogenously determined and subject to fluctuations.

The paper proceeds along the following lines. Section II reviews steps already taken in the process of normalization of U.S.-PRC relations and discusses one which has not yet occurred, eligibility of the PRC for the U.S. GSP program. Section III discusses methodological problems inherent in efforts to estimate the trade and employment impact on the U.S. economy of normalization, reviews the literature on this topic, and sets forth the methodology to be used in our estimates. Section IV reports the results of our estimates at aggregate and sectorial levels. Special emphasis is placed on a series of industries in the U.S. economy which have been adversely affected by imports in the past and which may be sensitive to additional imports from the PRC. Finally, Section V presents some tentative conclusions.

II. REVIEW OF THE STEPS IN THE NORMALIZATION OF U.S.-PRC TRADE

After a hiatus of more than 20 years, U.S.-PRC trade relations were reestablished in 1972 within the framework of the Shanghai Communique. Although undoubtedly the February 1972 Communique marks the first step in the normalization of U.S.-PRC trade relations, several unilateral U.S. actions in 1971-72 cleared the way for the resumption of trade.[2]

In April 1971, the President announced his intention to relax the total embargo on U.S. exports to the PRC in effect since December 1950. In May 1971, the Treasury Department removed controls on the use of dollars in transactions with the PRC and modified the regulations banning U.S. carriers' participation in PRC trade. In June, regulations were issued permitting the exportation to the PRC of selected nonstrategic commodities under general licenses (i.e., without Commerce Department review and approval) and of others subject to validated licenses. Also in June 1971, the December 1950 Foreign Assets Control Regulations banning the importation of goods from the PRC were modified to permit the entry of such items subject to non-MFN rates. In early 1972, export controls to the PRC were further relaxed and accorded the same treatment applicable to the USSR and Eastern Europe.

Between 1972 and 1974, trade expanded sharply as the PRC made large purchases of U.S. agricultural products and began to ship cotton textiles and basic commodities to the United States. The increase in trade was facilitated by the establishment in June 1973 of "Liaison Offices" with responsibilites for trade promotion and facilitation in each other's capitals. Despite a flurry of visits to the PRC by U.S. businessmen and to the United States by PRC officials, trade during 1974-78 declined as PRC purchases of U.S. agricultural commodities fell precipitously.

A. U.S.-PRC Trade Agreements

The President's decision in December 1978 to seek full normalization of diplomatic and economic relations with the PRC opened the way for the resolution of the outstanding problems impinging on the full development of U.S.-PRC trade: (1) the claims/assets issue; (2) the discriminatory (i.e., non-MFN) tariff treatment; and (3) the inability of the Eximbank to finance U.S. exports to the PRC.

Claims/Assets.—In May 1979, the United States and the PRC formally signed an agreement settling $197 million in outstanding claims by United States citizens against the PRC in return for $80.5 million in PRC assets previously frozen in the United States. Resolution of this issue was critical to the expansion of trade since there was some concern that PRC ships or aircraft landing in the United States could have been attached by claimants.

MFN Tariff Treatment.—In July 1979, a U.S.-PRC framework trade agreement providing, among others, for the mutual extension of nondiscriminatory (i.e., MFN) tariff treatment was signed. The U.S. Congress ratified it in early 1980. Effective February 1, 1980, U.S. imports of PRC goods began to be dutied at MFN tariff rates, which are typically lower than non-MFN rates.

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[2] William W. Clarke and Martha Avery (1975 and 1978).

Eximbank Financing.—Following a Presidental determination that extension of Eximbank financing to the PRC is in the national interest, Eximbank announced in June 1980 that its facilities were available to finance exports to the PRC. Although U.S. businesmen felt that this action would lower financing costs to the PRC and enhance the competitiveness of U.S. exports, the PRC has made very limited use of Eximbank, claiming that its rates are not competitive with those offered by other countries.

Other agreements.—Five agreements signed in the second half of 1980 further normalized U.S.-PRC trade relations: (1) a textiles bilateral agreement regulating PRC shipments of textiles and apparel to the United States; (2) a civil aircraft agreement authorizing direct air service between the two countries; (3) a maritime transport agreement providing access to each other's ports and instituting a cargo sharing arrangement; (4) a grains agreement providing for guaranteed levels of purchases of U.S. grain by the PRC; and (5) a pact between the two countries agreeing to the activation of investment incentive programs of the Overseas Private Investment Corporation (OPIC) in the PRC. U.S. export control policies vis-a-vis the PRC have been progressively relaxed to the point where exports to the PRC are treated more liberally than they have been to the USSR and other controlled countries.

In 1979–80, great strides were made toward the normalization of trade relations between the United States and the PRC. In response, two-way trade increased sharply, rising by nearly 100 percent in 1979 and 111 percent in 1980. As trade has increased, however, so has the PRC's deficit, raising the issue of whether the PRC can continue to import from the United States at these high levels.

Some analysts see extension of duty-free benefits to PRC goods under the Generalized System of Preferences (GSP) as a logical progression in the normalization process and one which may assist the PRC in redressing its trade imbalance with the United States. The next section reviews the main elements of the U.S. GSP system and considers the legal requirements for extending such benefits to the PRC. In Section IV, an estimate of the trade-expansion impact of extending GSP to the PRC is made.

B. Possible Granting of GSP

(i) The U.S. Generalized System of Preferences.[3]

Title V of the Trade Act of 1974 authorized the President to grant duty-free treatment to eligible product imports from beneficiary developing countries for a period of ten years beginning on January 1, 1976. In taking this action, the United States reacted to the long-standing claim by developing countries that their inability to compete on an equal basis with developed countries in the international trading system was a major impediment to their development and followed the lead of most of the developed countries who had already instituted generalized preferences schemes benefitting the developing countries.

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[3] For a comprehensive review of the U.S. GSP program see U.S. House of Representatives, Committee on Ways and Means, Report to the Congress on the First Five Years' Operation of the U.S. Generalized System of Preferences (GSP) (Washington: U.S. Government Printing Office, 1980).

Eligible Developing Countries.—According to Section 502(b) of the Trade Act of 1974, beneficiary status under the GSP program could be granted to developing countries, non-independent countries or territories unless they: (1) are Communist countries except those meeting additional criteria; (2) are members of the Organization of Petroleum Exporting Countries; (3) grant preferential tariff treatment to imports from other developed countries which have a significant adverse effect on U.S. trade; (4) have nationalized, expropriated or seized property owned by U.S. citizens or corporations without compensation; (5) do not cooperate with the United States to prevent the unlawful entry into the United States of narcotic drugs; or (6) fail to act in good faith in recognizing as binding arbitral awards in favor of U.S. citizens. Following these criteria, the President designated 98 countries and 39 territories as eligible for GSP effective January 1, 1976.[4] As a result of international agreements, amendments to the original legislation[5] and political developments abroad, GSP eligibility has been withdrawn for four countries or territories and granted to six others.[6]

Eligible Products.—In designating products eligible under the GSP scheme, Section 503(c) of the the Trade Act of 1974 specifically excluded the following: (1) textile and apparel articles subject to textile agreements; (2) watches; (3) import-sensitive electronic articles; (4) virtually all footwear imports, except zoris; (5) import-sensitive semimanufactured and manufactured glass products; (6) any other articles which the President determines to be import-sensitive in the context of the GSP; and (7) any article subject to action under Section 203 of the Trade Act of 1974 or section 351 of the Trade Expansion Act of 1962 (import relief resulting from escape clause) or section 232 of the Trade Expansion Act of 1962 (national security).

Taking into account these restrictions, the President designated, a total of 2729 items in the Tariff Schedules of the United States (TSUS) eligible for GSP treatment beginning January 1, 1976.[7] An administrative procedure for periodically modifying the product coverage of the GSP based on petitions filed by interested parties was instituted on December 31, 1975. Six product reviews leading to the addition of 132 and the deletion of 20 TSUS items from the original list of eligible products have been held since the GSP program became effective.[8] At present, over 2800 of about 7200 TSUS items are eligible for the U.S. GSP program.

Limitations.—In order to ensure a wide distribution of GSP benefits among beneficiary countries, Section 504 of the Trade Act of

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[4] The list of eligible countries is given in Executive Order 11888 of November 24, 1975. See Weekly Compilation of Presidential Documents, vol. 11, no. 48 (December 1, 1975), pp. 1312-1315.

[5] In October 1976, Title V of the Trade Act of 1974 was amended to prohibit GSP eligibility to countries which aid or abet international terrorism. Also, Section 1111 (a)(2) of the Trade Agreements Act of 1979 amended the Trade Act of 1974 to allow the President to designate OPEC members as beneficiary countries provided such countries entered into a bilateral product-specific trade agreement with the United States.

[6] Eligibility was withdrawn for Laos, Portuguese Timor, Ethiopia and Afghanistan and added for Portugal, Uganda, Zimbabwe, Indonesia, Venezuela, and Ecuador.

[7] The list of eligible items was published in the Federal Register (November 26, 1975), pp. 55290-55306.

[8] For a comprehensive list of the modification see Report to the Congress on the First Five Years' Operations of the U.S. Generalized System of Preferences (GSP). op.cit., Appendix III-B, pp. 104-109.

1974 established criteria to withdraw preferential treatment for particular products from beneficiary countries as these countries became competitive. According to the criteria set forth, a beneficiary country's exports to the United States in a given category would cease to be subject to preferential treatment if, in a calendar year: (1) they exceeded in value an absolute dollar limit;[9] or (2) they accounted for 50 percent or more of the value of U.S. imports in that category. (This limitation does not apply to eligible articles not produced in the United States at the time of the enactment of the statute, January 3, 1975.) A country which ceases to be treated as a beneficiary country for a given product as a result of the competitive need limits may be redesignated if its imports fall below the limits in a subsequent year.

C. Statutory Requirements for Designating the PRC as Eligible for GSP

At the time the U.S. GSP program was promulgated, the People's Republic of China did not meet the statutory requirements for eligibility on several accounts. The process of normalization of diplomatic and economic relations between the United States and the PRC, as well as other actions taken by the PRC in 1979-80, have removed some of the legal impediments to GSP eligibility for the PRC, but others remain.

General Requirements.—According to Section 502(c) of the Trade Act of 1974, the President may designate a country as a beneficiary under the GSP program, subject to other specific provisions of the Act, taking into account the following (1) an expression by the country of its desire to be so designated; (2) the level of economic development of the country, including its per capita GNP, the living standards of its inhabitants, and any other economic factors deemed appropriate; (3) whether or not the other major developed countries are extending generalized preferential treatment to the country; and (4) the extent to which the country has assured the United States it will provide equitable and reasonable access to its markets and basic commodities. Although the PRC has not publicly requested eligibility in the U.S. GSP program, there is little doubt that it meets the substantive requirements which are discussed below.

Level of Development.—GSP beneficiary status is reserved for developing countries. While statistical data on the PRC are very weak and prevent determination of its level of development based on per capita GNP or some other quantitative indicator,[10] reasonable observers agree that the PRC is a developing country. Moreover, the July 1979 trade agreement between the United States and the PRC explicitly notes (Article II.3) that "at its current stage of economic development, China is a developing country." [11]

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[9] The statute set the limit at $25 million for 1974. After that, the limit was to increase each year by indexing the original limit by the ratio of current GNP to 1974 GNP. Thus, the dollar value competitive need limit was $26.6 million for 1975, $29.9 million for 1976, $33.4 million for 1977, $37.3 million for 1978 and $41.9 million for 1979. See ibid, p. 23. Section 1111 of the Trade Agreements Act of 1979 amended the statute to waive the 50 percent competitive need rule for categories in which U.S. imports were valued at less than $1 million in 1979. This absolute de minimis level will also be adjusted annually to reflect the growth in GNP.

[10] For instance, the World Bank in its recent World Development Report, 1980 (Washington: The World Bank, August 1980), p. 111, estimates PRC GNP per capita for 1978 at $230. This GNP per capita level would place the PRC near the middle of the low-income countries. The same source (p. 158) cautions that the estimate is tentative and may not be comparable to other data.

Treatment in GSP programs of other developed countries.—At present, market economies have 11 programs extending preferences to exports from beneficiary developing countries.[12] As of early 1981, the People's Republic of China had been granted beneficiary status under 8 out of 11 GSP schemes of developed countries.[13] Thus, Finland, Sweden and the United States are the only developed countries not extending GSP benefits to the PRC.

Access to basic commodities.—Article II of the July 1979 U.S.-PRC trade agreement stipulates that trade between the two countries will be effected on a nondiscriminatory basis. This nondiscriminatory treatment also applies to quantitative import or export restrictions which may be imposed by the United States or the PRC. The PRC neither is nor has been a member of the Organization of Petroleum Exporting Countries or of any other international cartel restricting international trade in basic commodities.

Requirements for Communist Countries.—In addition to the general considerations above, a Communist country must meet additional criteria set forth in Section 502(b)(1) of the Trade Act of 1974 to become eligible for the U.S. GSP program. These requirements are: (a) its exports to United States are subject to most-favored-nation tariff treatment; (b) it is a contracting party to the General Agreement on Tariffs and Trade (GATT) and a member of the International Monetary Fund (IMF); and (c) it is not dominated or controlled by international Communism. The extent to which the PRC meets these requirements is discussed below.

Most-favored-nation status: The July 1979 U.S.-PRC trade framework agreement provides for mutual nondiscriminatory or most-favored-nation (MFN) tariff treatment of goods traded between the two countries. The agreement, which conforms with the requirements of Section 405 of the Trade Act of 1974, became effective on February 1, 1980 for a three-year period.

Membership in GATT and IMF: On April 17, 1980, the PRC became a full member of the IMF. The IMF Executive Board decided that the PRC represents "China" and recognized it as the official representative in the IMF.[14] "China," a member of the IMF since 1946, had been represented by the Republic of China (Taiwan) since 1949. As of mid-1981, the PRC was not a contracting party to the GATT nor had it begun the process of GATT accession.[15]

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[11] The text of the agreement is reproduced in Weekly Compilation of Presidential Documents, vol. 15, no. 43 (October 29, 1979), pp. 2001-2005.

[12] The programs vary substantially across grantor countries with reference to commodity coverage, country eligibility and limitations. For comprehensive descriptions and comparisons of the GSP schemes see the series of annual reviews submitted to the Special Committee on Preferences of the United Nations Conference on Trade and Development. United Nations Conference on Trade and Development, Operations and Effects of the Generalized System of Preferences (New York: United Nations, 1974) and more recent issues.

[13] Australia (from October 1978), New Zealand (October 1978), Norway (March 1979), Switzerland (July 1979), Canada (December 1979), Austria (January 1980), EEC (January 1980), and Japan (April 1980). Five non-market economies (Bulgaria, Czechoslovakia, Hungary, Poland and the Soviet Union) have GSP-type programs. The PRC is not a beneficiary under any of these programs. See Operations and Effects of the Generalized System of Preferences, op. cit.

[14] IMF Press Release No. 80/32 (April 17, 1980).

[15] For a discussion of the options available to the PRC for GATT accession and of the implications [illegible] contracting parties of each approach see the Liser article in this volume.

Domination or control by international communism: To date, the determination by the President whether or not the PRC is "dominated or controlled by international Communism" has not been made.[16]

Thus, at the time of this writing, there are several requirements which stand in the way of PRC eligibility under the U.S. GSP program. First, as a general requirement, the PRC must request inclusion in the program. Second, the PRC must become a contracting party to the GATT. And third, the President must make a determination that the PRC is not dominated or controlled by international communism.

III. ESTIMATING THE EFFECTS ON U.S. IMPORTS AND EMPLOYMENT OF U.S.-PRC TRADE NORMALIZATION: METHODOLOGICAL CONSIDERATIONS

There are two major economic policy questions involved in analysis of the impact of U.S. tariff reductions on imports from the PRC: (1) how will the volume and composition of imports change; and (2) how will these changes affect U.S. output and employment, especially in certain import-sensitive industries? Attempts to provide empirical answers to these policy questions are beset with methodological and data problems as well as with uncertainties associated with PRC behavior. This section briefly discusses how these policy questions might be addressed, reviews the major difficulties involved in analyzing MFN or GSP tariff reductions, assesses several recent estimates of the impact of tariff reductions on U.S. imports from the PRC, and presents the methodology used in this paper.

A. Methodological Issues

A reduction of U.S. tariffs on Chinese goods to MFN or GSP levels ceteris paribus will cause U.S. imports from the PRC to increase as buyers substitute the now lower-priced Chinese goods for: (1) domestic goods (trade creation); and (2) imports from other countries (trade diversion).[17] The total expansion of U.S. imports from the PRC is the sum of the trade creation and trade diversion effects.

The decomposition of the total trade expansion effects of a tariff reduction into trade creation and trade diversion has important analytical and policy implications. If policy-makers are interested in the impact of tariff reductions on U.S. output and employment, the measurement of trade creation—the fraction of total trade expansion which substitutes for displaced domestic production—is the relevant estimate. On the other hand, if the interest lies, for instance, in determining changes in Chinese dollar earnings from exports to the United States, total trade expansion is the appropriate measure.

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[16] Though the statute does not elaborate on the criteria for such a determination, there is precedent in this matter relating to the designation of Romania as eligible for GSP, the only Communist country to be so designated. In November 1975, President Ford wrote to the Congress indicating his intention to designate Romania as beneficiary for the GSP program. In substantiating that Romania was not under the control of internation communism the President cited "the repeated manifestation of Romanian determination to pursue an independent foreign policy." The letter is reproduced in *Public Papers of the Presidents of the United States—Gerald R. Ford*, Book, II 1975 (U.S. Government Printing Office, 1977), pp. 1840-1843.

[17] It is assumed that there exist foreign and/or domestic substitutes for all U.S. imports from the PRC.

The elasticity approach is a commonly used method of measuring the trade expansion, trade creation, and trade diversion effects of a tariff reduction. This approach requires the use of U.S. import demand and PRC export supply elasticities to determine the responsiveness of U.S. buyers and Chinese sellers to changes in U.S. import duties on goods imported from the PRC. In addition to the appropriate elasticities, it is necessary to make assumptions or inferences about the potential PRC price response to a change in U.S. import duties. Subject to supply constraints, the PRC may pass through all, some, or none of the duty reduction to U.S. buyers by maintaining export prices unchanged, raising them by a fraction of the tariff reduction, or raising them by the full amount of the tariff change. The magnitude of the pass-through, given current Chinese production possibilities, depends on the degree of monopoly power (the U.S. import demand elasticity for PRC goods) and Chinese planners' preferences. If U.S. import demand were very unresponsive to price changes, the PRC authorities might simply raise export prices by the amount of the tariff reduction in order to maximize short run dollar earnings.[18] On the other hand, if PRC foreign trade planners were interested in increasing their share of the U.S. market, they might pass through the entire tariff reduction to U.S. consumers.[19] Total trade expansion, then, depends on the U.S. import demand elasticity, the PRC export supply elasticity and pricing strategy, the magnitude of the change in U.S. tariffs, and the current volume of U.S. imports from the PRC.

There are several ways to estimate the trade creation and trade diversion components of trade expansion. The most direct approach is to estimate trade diversion alone and to derive trade creation as the residual between trade expansion and trade diversion. Trade diversion, the extent to which U.S. buyers will substitute lower-priced imports from the PRC for imports from other countries, is measured by the cross-price elasticity of demand. Given an estimated or assumed change in U.S. import prices for Chinese goods, the cross-price elasticity can be used to calculate the displacement of imports from other countries by Chinese imports, i.e., trade diversion.

Given estimates of the trade creation effects of the tariff reduction, the displacement of domestic production by increased imports depends on the substitutability of imports for similar U.S. goods. The elasticity of substitution between imports and domestic goods is the appropriate measure of these substitution possibilities. In addition, translating domestic output changes into employment changes requires a measure of the responsiveness of producers' demand for labor to changes in output, the output elasticity of employment. Given estimates of the short- and long-run output elasticities of employment, it is then possible to calculate the initial domestic employment impact of the tariff reduction, the time path of labor market adjustment, and the ultimate long-run effects on U.S. employment.[20]

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[18] If export prices rise by the amount of the tariff reduction there will be no substitution of Chinese imports for either domestic goods or imports from other sources because the relative prices of these goods to U.S. buyers will be unchanged.

[19] This strategy is particularly plausible if the products in question are likely to be subject to future U.S. import restraints, with the quotas allocated according to historical market shares. See T. Bayard, J. Orr, J. Pelzman and J. Perez-Lopez (1981).

Although the approach just outlined is conceptually fairly straightforward, attempts to implement it are confounded by a number of methodological and data problems. A major methodological problem with the basic elasticity approach is that it cannot be used to estimate trade expansion for PRC products currently subject to prohibitive U.S. import duties. This problem arises because the elasticities must be estimated on historical data and applied to base levels of historic trade in order to yield estimates of trade changes. If historical data do not exist because tariffs are prohibitive, there is no basis to estimate elasticities and no trade base to which to apply them.[21]

The fact that the process of normalization of U.S.-PRC trade relations has begun only recently poses another methodological problem for the elasticity approach. The methodology can be applied to any given historical trade base to estimate increases in trade which would have resulted solely from a reduction in U.S. tariffs. However, in this case the historical trade base itself may not reflect the "normal" flows which would have existed if both partners were fully aware of market conditions and trading opportunities. U.S.-PRC trade has grown rapidly in recent years, in large part precisely because traders have been able to discover a basis for trade due to differences in production costs and demand patterns. The elasticity approach can measure only one facet of the normalization process—that part due to the reduction in tariffs. It cannot measure the changes in trade volume and composition which are due to traders learning about a comparative advantage basis for trade between the United States and the PRC—the so-called "getting to know each other" effect referred to earlier.

A third methodological problem, PRC export pricing policy, was alluded to earlier. There is no generally accepted methodology for estimating how PRC export prices will change in response to U.S. tariff reductions. Since any assumption about the behavior of Chinese prices is a more or less well-informed guess, a potentially large error is introduced into the analysis.

The elasticity approach is also beset with severe data problems. As noted earlier, the approach requires information on the U.S. elasticity of demand from the PRC. Given the short period of U.S.-PRC trade and the lack of adquate disaggregated import price data, it is almost impossible to estimate the appropriate U.S. import demand elasticity. Data limitations also have precluded reliable estimates of Chinese export supply responsiveness and of the elasticity of substitution between imports from the PRC and other sources. Finally, although there do exist estimates of the elasticity of substitution between imports and domestic goods and of the output elasticity of employment, these estimates also are subject to wide margins of error.

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[20] See J. Pelzman and R. Martin (1981).

[21] It is possible to use elasticities based on similar imports from other countries, but the trade base problem remains.

Thus, although the elasticity approach in principle can be used to answer the policy questions posed earlier, in practice the data and methodological problems are such as to introduce potentially wide margins of error into the analysis. In what follows, we critically evaluate several recent attempts to analyze the impact of U.S. tariff reductions on Chinese goods in terms of their ability to provide reliable empirical answers to the policy questions posed above.

B. Survey of Recent Estimates

Despite its shortcomings, most of the recent analyses of the impact on the U.S. of MFN or GSP tariff reductions for PRC goods have employed some version of the basic elasticity approach. One of the best of these studies was conducted by Lincoln and Kilpatrick (L-K) using 1975 trade data.[22] Most subsequent studies have relied heavily on the L-K model.

Recognizing that the 1975 volume and composition of U.S. imports from the PRC did not reflect "normal" trade, L-K adjusted the trade base by assuming that under normal conditions the Chinese share of the U.S. import market would equal their share of European Community imports. Given the short duration of U.S.-PRC trade, they used trade data from "analog countries" (i.e., countries similar to the PRC in trade structure) to estimate U.S. import demand elasticities. L-K chose to estimate only trade expansion, rather than trade creation, because of the lack of reliable estimates of the import cross-price elasticity. L-K recognized that the use of trade expansion estimates would bias upward their estimates of the impact of MFN on U.S. employment. They also appear to have assumed 100 percent pass-through of the tariff reductions to U.S. buyers.

The major results of the L-K study are shown in Table 1. Their estimates suggest that as a result of MFN tariffs, U.S. imports from the PRC would increase by roughly 25 percent of their projected trade base. The sectors most affected by MFN would be textiles and apparel, pottery, footwear, toys, games and sporting goods, and chemicals. As the theory of comparative advantage would predict, most of these sectors are unskilled labor intensive. Overall, the L-K study indicates that the impact of MFN is very small, but that the effects tend to be concentrated in several import-sensitive domestic sectors.[23]

The domestic employment impact in the L-K study was estimated by assuming that Chinese imports substitute for domestic output on a dollar-for-dollar basis. L-K then multiplied the change in imports by labor-output ratios derived from the Department of Labor Input-Output model. This yielded the total employment impact of MFN, including indirect effects. The use of total (i.e., direct plus indirect) labor-output coefficients precluded any analysis of the sectorial distribution of the indirect employment effects. As is discussed below, these indirect effects can be potentially important. Depending on their elasticity assumptions, L-K estimated a loss of 2,000 to 6,000 U.S. job opportunities due to MFN extension.

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[22] Philip T. Lincoln and James A. Kilpatrick (1978). Lincoln and Kilpatrick have a very good survey of early research in this area.

[23] There are several potential upward biases in the L-K analysis: (1) the use of trade expansion, (2) the assumption that all of the labor impact would be in the form of labor displacement and (3) the 100 percent pass-through assumption. This second bias is discussed in more detail below. On the other hand, the elasticity estimates employed are surprisingly low. This suggests there may be an offsetting downward bias in their trade and employment estimates.

A study by Raffel, Teal and McQueen (RTM) used a comparative market share approach to estimate the import impact of both MFN and GSP tariff reductions.[24] Using 1976 trade data, RTM estimated market share equations for 19 importing areas. The share of each market in total Chinese exports to the 19 areas was assumed to depend on the distance between the PRC and the export market, demand conditions and tariff and non-tariff barriers.

In the context of the earlier discussion of trade expansion, trade creation and trade diversion, it is not entirely clear how to interpret the RTM results. Since it is the U.S. share of total Chinese exports, rather than the Chinese share of total U.S. imports, which is estimated, there is no implication in the analysis of any trade diversion in the usual sense of the term. If for no other reason than by default, it seems reasonable to assume that their estimates approximate total trade expansion.[25] Unlike Lincoln and Kilpatrick, RTM do not necessarily assume 100 percent pass through of the tariff reduction. Rather, PRC export pricing policy is implicitly incorporated into the analysis by measuring the responsiveness of Chinese export shares to differences in trade barriers.

The results of the RTM study are very similar to those of Lincoln and Kilpatrick. They find the MFN tariff reductions would cause a 30 percent increase in U.S. imports from the PRC and that GSP tariff reductions would lead to a 4 percent increase. The sectors likely to be affected are also similar: textiles, apparel, footwear, pottery and basketwork. Their results are summarized in Table 1.

The U.S. International Trade Commission's (USITC) study of the impact of MFN tariff treatment for the PRC also used the basic elasticity framework.[26] The USITC study was based on 1978 trade data, with projections of the trade base to 1984. Using Lincoln and Kilpatrick's elasticities, the USITC estimated that the value of U.S. imports from the PRC would increase by less than five percent if all of the tariff reduction was passed on to U.S. buyers. On the alternative assumption of no pass-through, the trade increase was estimated to be about 13 percent of the trade base. Like the Lincoln-Kilpatrick estimates, these results should be interpreted as estimates of trade expansion—no attempt was made to measure trade creation or its domestic impact.

Although the USITC analysis was conducted at a detailed level, the study did not report disaggregated results. The Commission staff did develop specific trade projections for textile and apparel imports. However, the report does not provide details on how current U.S. import restraints on these items were handled in the analysis or about the effects of MFN tariff reductions on textile and apparel imports.

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[24] Helen Raffel, Robert E. Teal, and Cheryl McQueen (1978).

[25] Perhaps because of the difficulty in interpreting their results, RTM do not attempt to estimate the domestic impact of the tariff reductions.

[26] U.S. International Trade Commission (1979). See also Janet Whisler (1977) for an earlier USITC study of MFN for the PRC.

The Department of Labor (DOL) study of MFN applied the elasticity approach to 1978 tariff-line import data.[27] The DOL study relied on import demand elasticities collected by Baldwin.[28] Here again, the estimates approximated total trade expansion. The detailed industry results were translated into domestic production and employment results using an input-output model of the economy.

Ignoring the impact of U.S. restraints on apparel imports from the PRC, the study estimated that total U.S. imports from the PRC would increase by approximately 25 percent with a loss of 6,000 employment opportunities if the tariff reductions were passed through. Assuming no pass-through, it was estimated that the value of imports would increase by only 6 percent. These estimates of the effects of the pass-through differ from the USITC's because of differences in the assumed import demand elasticities: the DOL elasticities are generally higher than the USITC's.

The DOL study also attempted to incorporate the likely effects of the 1978 U.S. restraints on Chinese apparel imports. The presence of these restraints substantially reduced the potential trade and employment impact of MFN tariff reductions. It was estimated that with restraints, trade expansion would be roughly 18 percent of the trade base, compared to about 25 percent without import restraints. The job opportunity losses would also decline from 6000 to 4000. The sectorial estimates in the DOL study are consistent with the other studies surveyed here. The domestic industries likely to be affected are textiles and apparel, footwear, pottery and miscellaneous manufactures. Most of the indirect employment impact of the tariff reductions occurred in textiles. The import restraints on apparel greatly reduced the employment effects in both the apparel and (indirectly) the textile industries.

TABLE 1.—RECENT ESTIMATES OF THE IMPACT OF MFN OR GSP TARIFF STATUS ON U.S. IMPORTS FROM THE PRC

Study	Changes in U.S. imports (percent)	Industries affected
Lincoln and Kilpatrick (1978)	25 for MFN	Chemical products; textiles; pottery; clothing; toys, games, sporting goods; footwear; miscellaneous manufactures.
Raffel, Teal, McQueen (1978)	30 for MFN, 4 for GSP	Textiles; pottery; apparel; basketwork.
USITC (1979)	5 to 13 for MFN	Not available.
U.S. Department of Labor (1979)	6 to 25 for MFN	Textiles; apparel; pottery; footwear; miscellaneous manufactures.

A fairly consistent story emerges from the recent studies of the impact of MFN on U.S. imports from the PRC. The absolute magnitude of the impact of the tariff reductions on U.S. imports and employment is quite small, in large part because U.S. imports from the PRC, although they are growing rapidly, are small in comparison with total U.S. imports and domestic output. The studies suggest that MFN tariff reductions per se cause a 15 to 30 percent increase in the trade base. However, the results also indicate that the increase in imports is concentrated in a few sectors in which domestic import-competing production is characterized by high labor and low skill content. Many of these sectors are already sensitive to imports from other countries.

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[27] T. Bayard, J. Orr, J. Pelzman and J. Perez-Lopez (1981).

[28] R. E. Baldwin (1976). Baldwin's elasticities are based on total U.S. imports, rather than on U.S. imports from the PRC.

C. Methodology

In this paper, an elasticity approach is used to estimate the impact on U.S. imports and employment of extending MFN and GSP tariff treatment to the PRC. The model used to estimate the effects of tariff reductions is based on one developed by Robert Baldwin.[29]

Assuming that all of the tariff reduction is passed through to U.S. buyers in the form of lower prices, the change in U.S. imports resulting from either MFN or GSP tariff reductions is estimated at the five-digit tariff line level as:

$$M = M_0 \cdot \Delta t/1+t \cdot E \qquad (1)$$

where

M_0 is the 1979 c.i.f. value of dutiable imports from the PRC;
$\Delta t/1+t$ is the change in the U.S. import price due to the tariff reduction.
E is the elasticity of U.S. import demand.[30]

Import data for 1979 were used because they were the latest disaggregated data available at the time of the study.

A basic assumption underlying the model is that the supply of PRC exports is perfectly elastic. That is, despite increased U.S. imports of PRC goods, export prices of these goods remain fixed and exporters pass through to importers the full amount of the tariff reduction. The alternative is to assume either no pass-through, in which case there is no change in U.S. import-competing output and employment, or to assume some intermediate pass-through, either on an across-the-board basis, or on an industry-specific basis. Since we have no a priori basis for knowing the likely magnitude of the pass-through, the full pass-through assumption was used. Analysts who have reason to believe that the Chinese will not hold their export prices constant can scale our results accordingly.

The estimates pertain to total trade expansion: they include both trade creation and trade diversion. In the absence of reliable estimates of the elasticity of substitution between imports from the PRC and imports from other sources, and between imports from the PRC and domestic production, it is assumed that the increase in imports from the PRC displaces only domestic output, and does not affect imports from other sources. In addition, it is assumed that the increased imports from the PRC displace domestic goods on a dollar-for-dollar basis.[31]

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[29] R. E. Baldwin (1976).

[30] The elasticities are from Baldwin (1976). These elasticities are for total U.S. import demand rather than for imports from the PRC. Thus, the analysis assumes that import elasticities estimated on total imports (by four-digit input-output sector) also represent the response of domestic buyers to changes in the price of imports from the PRC.

The estimated changes in imports at the tariff-line level are aggregated to the 4-digit level of the 1967 U.S. input-output table, and deflated to 1967 producer values. These deflated values, representing domestic production displaced by imports on the dollar-for-dollar substitution assumption, are then multiplied by the inverse of the 1967 input-output matrix and by a matrix of labor-output coefficients.

In matrix notation, the employment impact of the production changes resulting from the tariff reductions is estimated as:

$$L_m = L\,(I-A)^{-1}\,M \tag{2}$$

where,

L_m is a 367×1 vector of changes in employment opportunities;
A is a 367×367 input-output coefficient martix;
M is a 367×1 vector of estimated changes in imports; and
L is a 367×367 diagonal matrix of labor-output coefficients.

The employment estimates shown in the next section are job opportunities and are not necessarily actual changes in employment. At least part of the estimated loss in job opportunities due to increased imports may be offset in many industries by normal industry growth, voluntary job transfers and retirements, and by increased U.S. exports to the PRC.[32] The model may also overestimate the employment impact of the tariff reductions if there is less than full pass-through and/or any trade diversion.

The trade diverson question is very important. In order to obtain a rough estimate of the potential for Chinese exports to the United States to displace third country exports, we use an index developed by Finger and Kreinin to measure the similarity of Chinese exports to the U.S. relative to other LDCs exports to the U.S. market.[33] The rationale behind the use of this index is that, the greater the similarity in the baskets of goods exported to the United States from the PRC and other countries, the greater is the probability that PRC goods will displace other countries' exports to the United States.[34]

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[31] This assumption may cause over- or under-estimates of the domestic impact of increased imports. For example, previous attempts to estimate the substitution of textile imports for domestic textiles have shown that the substitutability varies substantially at the product level. See J. Pelzman and R. Martin (1981).

[32] U.S. exports to the PRC of textile fibers (mainly raw cotton and man-made fibers) and finished or semi-finished textile products accounted for 26.4 percent of U.S. exports to the PRC in 1979 and 27.4 percent in 1980. U.S. imports from the PRC in this area consist primarily of finished textile products, in particular apparel. See "Textile Fibers and Textile Products to China", in U.S. International Trade Commission, 26th Quarterly Report to the Congress and the Trade Policy Committee on Trade Between the United States and the Nonmarket Economy Countries During January-March 1981, Publication 1161 (Washington: USITC, 1981), pp. 45-66.

[33] J. M. Finger and M. Kreinin (1979).

[34] The substitutability issue raises the difficult question of the impact of MFN or GSP status on the alleged illegal transshipment (re-export) of Chinese goods from third countries. Without prejudging the issue of whether these alleged illegal shipments occur, if receipt of MFN or GSP status causes the PRC to by-pass these third countries and export directly to the United States, and if these third countries are also able to increase their exports of similar products to pick up the "slack" left by the diversion of former re-exports, there may be less trade diversion than the similarity index would suggest. This is especially true if the transshipped goods were subject to binding U.S. import restraints. The quantitative implications of illegal transshipments are difficult to assess because there are no data. For attempts to estimate legal re-exports see S. Klein (1970) and A. Eckstein (1966).

The Finger-Kreinin (FK) index is calculated by the following formula:

$$S_{(ij,\ k)} = \left[\sum_h \text{Minimum} \left(\frac{X_h^{ik}}{\sum_h X_h^{ik}} , \frac{X_h^{jk}}{\sum_h X_h^{jk}} \right) \right] * 100 \quad (3)$$

where,

$S_{(ij,\ k)}$ is the similarity index of countries i and j (the PRC and another LDC) exports to a common market k (the U.S.);

$X_h^{jk}; X_h^{ik}$ are exports of commodity h by country j (i) to market k; and

$\frac{X_h^{jk}}{\sum_h X_h^{jk}}$ is the share of commodity h exports by country j in total country j exports to market k.

If the commodity distribution or market basket of countries i and j's exports to market k are identical, the FK index will equal unity. On the other hand, if the two export vectors are completely dissimilar, the index will equal zero. As a similarity indicator, the FK index can only be used to determine the extent to which one export vector is similar to another single export vector in a given import market. The index can be applied either to two countries in the same time period or over time. Equation (3) can be transformed to read:

$$S'_{(ij,\ k)} = \left[1 - 1/2 \quad \left(\text{ABS} \quad \left(\frac{X_h^{ik}}{\sum_h X_h^{ik}} - \frac{X_h^{jk}}{\sum_h X_h^{jk}} \right) \right) \right] * 100 \quad (4)$$

Using this index we can compare the similarity of PRC exports to the United States with exports from other LDCs. The countries whose baskets of exports to the United States over the period 1975–79 were compared to the PRC's include Indonesia, Taiwan, India, Malaysia, South Korea, Hong Kong, Singapore and Mexico. These countries were chosen for a number of reasons. With the exception of Mexico, they are all in the same geographic area as the PRC. Given their geographic proximity, we can isolate one important factor which may hinder U.S.-PRC trade—transportation costs.

It was not possible, however, to compare PRC and other countries' exports based on "systemic similarity" or MFN status. An appropriate comparison standard for the PRC on the basis of "systemic similarity" would be another centrally planned economy (CPE). However, given the unavailability of data on the Asian CPEs and the dissimilarity in resource endowments and trade patterns between the PRC and European CPEs, this comparison was considered otiose. The problem of MFN status is a different matter. All of the comparison countries have MFN status with the United States. The PRC, on the other hand, has enjoyed MFN treatment only

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since February 1, 1980. Consequently, a comparsion across 1975–79 ignores the impact that MFN may have had on the commodity composition of Chinese exports to the United States. Despite these drawbacks, the similarity index comparisons of export vectors can be used to rank the most likely countries whose exports may be displaced by "normal" U.S.-PRC trade. These index comparisons can also help to identify the commodities which might be displaced by Chinese exports, although these commodity predictions (because they are disaggregated) are less accurate than the country predictions.

IV. TRADE AND EMPLOYMENT EFFECTS OF U.S.-PRC TRADE NORMALIZATION

This section presents estimates of the impact on U.S. imports and employment of tariff reductions on imported goods from the PRC. The estimates are presented at both aggregate and sectorial levels. The sectorial analysis is used to identify as closely as possible the domestic import-competing sectors which may be adversely affected by increased imports from the PRC. Special emphasis is placed on a comparison of the industries which have been trade-sensitive in the past with those industries which are likely to be adversely affected by the expansion of U.S.-PRC trade. In addition, the trade creation/trade diversion issue and the possibility that future changes in the commodity composition of U.S.-PRC trade will adversely affect additional domestic sectors are examined using a trade similarity index.

A. Aggregate Effects of Tariff Reductions on U.S. Imports and Employment

Estimates of changes in imports of PRC goods at aggregate and selected broad sectorial levels due to the tariff reductions are given in columns 2 and 6 of Table 2. The estimates are based on actual 1979 trade. According to the model, in 1979 U.S. imports from the PRC would have exceeded actual imports ($528 million) by approximately $134 million, or 25.3 percent, had PRC imports been dutied at MFN rates throughout the year (column 2). This increase in imports attributable to MFN is in line with our earlier estimate of a 25–35 percent increase derived using data for 1978.[35] Particularly significant would have been increases in imports of ceramic products (94 percent), footwear (63 percent), and textiles and apparel (50 percent). These increased imports would have translated into a loss of approximately 8,600 employment opportunities in the United States (column 3). The textile and apparel industry alone would have accounted for approximately 4,600 (50 percent) of the total loss of employment opportunities.

Had the PRC also enjoyed country-beneficiary status under the U.S. GSP program during 1979, U.S. imports from the PRC in that year would have exceeded actual and MFN imports by $22.2 million, or 4.2 percent (column 6). GSP would have increased imports of Chinese ceramic products by 48 percent. The increase would have been 25 percent for the furniture and wood products industry.

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[35] See Bayard, Orr, Pelzman and Perez-Lopez (1981).

The employment impact of additional imports generated by GSP beneficiary status has not been calculated because the relatively small changes in imports make the results unreliable.

TABLE 2.—CHANGES IN IMPORTS OF PRC GOODS AND EMPLOYMENT OPPORTUNITIES ATTRIBUTABLE TO MFN AND GSP

[In thousands of dollars and man-years]

	1979 imports from PRC	Without restraints		With restraints		Change in 1979 imports of PRC goods attributable to GSP	
		Changes in 1979 imports	Reduction in employment opportunities	Changes in 1979 imports	Reduction in employment opportunities	Ignoring competitive need limits	Considering competitive need limits
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
All Categories	528,056	133,717	8,613	67,952	3,743	22,215	14,152
Textiles and apparel [1]	186,013	93,480	4,565	27,715	1,185	3,298	953
Chemicals [2]	52,215	5,517	227	5,517	137	2,172	558
Furniture and Wood products [3]	22,832	8,793	282	8,793	276	5,740	2,695
Footwear [4]	14,153	8,896	253	8,896	253	56	56
Food products [5]	38,344	1,322	27	1,322	19	461	370
Leather products [6]	3,553	2,023	101	2,023	94	140	140
Ceramic products [7]	3,787	3,559	116	3,559	113	1,825	1,703

[1] I-O sectors—16-19.
[2] I-O sectors—27-29.
[3] I-O sectors—20-23.
[4] I-O industries—3202, 3401, 3402.
[5] I-O sectors—14.
[6] I-O sectors—33 and industry 3403.
[7] I-O sectors—36.

The employment estimates shown in Table 2 and throughout this paper are employment opportunities and are not necessarily actual changes in employment. For example, the estimate that 8600 job opportunities would have been lost if MFN had been extended to the PRC in 1979 does not necessarily mean that 8600 layoffs would have occurred. At least part of the estimated loss in job opportunities would have been offset in many industries by normal industry growth, voluntary job transfers and retirements, and (especially in textiles) by increased U.S. exports to the PRC.

The estimates of increased imports from the PRC resulting from MFN and GSP tariff reductions reported in Table 2 do not take into consideration several factors which might prevent imports from increasing. Two such limiting factors are quantitative import restraints which limit the volume of specific PRC goods which can be imported and competitive need criteria which limit the value of certain imports eligible for duty-free treatment under the U.S. GSP program.

Restrictions on imports of PRC apparel products (discussed in detail in the next section) and GSP competitive need criteria have been incorporated into the analysis and an alternate set of estimates is given in columns 4 (MFN) and 7 (GSP) of Table 2. Import restrictions on apparel reduce the overall trade expansion impact of MFN extension to approximately $68 million, or 12.9 percent of 1979 trade, and reduce employment losses from 8600 to 3740 job opportunities. For the textile and apparel industry, the restrictions reduce the estimated increase in imports from $94 million to $28 million, and employment opportunities losses fall from approximately 4600 to 1200. Introduction of the competitive need limits on GSP imports reduces trade expansion to $14.2 million, or 2.7 percent of 1979 trade. For chemicals and textiles and apparel, competitive need criteria would have reduced import increases in these sectors resulting from GSP by about three-fourths.

It should also be noted that the estimated import and employment effects resulting from MFN and GSP tariff reductions refer to trade expansion and therefore tend to overestimate the employment impact. As noted in Section III, estimation of the trade creation and trade diversion components of trade expansion requires the use of both the substitution elasticities of PRC imports for similar U.S.-produced goods and of PRC products for similar products from third countries. In the absence of information on these elasticities, it was assumed in the preceding analysis that imports from the PRC would displace only domestic production. However, in an attempt to shed some light on the important trade diversion issue, we have used an export similarity index, described in Section III, as an indicator of the extent to which PRC and other LDC exports to the United States are similar and therefore may substitute for each other. The higher the similarity in the basket of goods exported to the United States from the PRC and other countries, the greater the probability that the PRC goods will displace third country exports. The higher the trade diversion factor in total trade expansion, the smaller will be the impact of increased imports from the PRC on U.S. output and employment.

Table 3 presents similarity indexes for exports to the U.S. market from the PRC and key LDC exporters for the period 1975–79. According to the data in Table 3, in 1975 Malaysian exports to the United States were most similar to those of the PRC (27 percent). In the post-1975 period, the export baskets to the United States of other LDCs and the PRC have become more similar. For example, 30 percent of India's exports to the U.S. in 1976 and 36 percent of exports in 1979 were in the same commodity groups as those of the PRC. For Hong Kong in 1976, 20 percent of its exports were concentrated in the same commodities as those of the PRC; by 1979 the similarity rose to 33 percent.

Given these results, it is useful to determine the commodities responsible for this similarity in export vectors. Table 4 lists the top five commodities for which exports to the U.S. from Hong Kong, India, South Korea and Mexico were most similar to those of the PRC in 1979.[36] As the data demonstrate, the greatest similarity exists in trade in cotton textiles, apparel, and footwear. Given normalized U.S.-PRC trade, PRC shipments in these commodities may (but need not) substitute for similar exports from Hong Kong, India, Mexico, South Korea and other LDCs. These findings suggest that our estimates of the impact of the tariff cuts on imports and employment opportunities may be overstated because they fail to consider the extent to which increased PRC imports may displace imports from other LDCs.

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[36] Trade data for Taiwan were unavailable for 1978–79.

TABLE 3.—SIMILARITY OF PRC EXPORTS TO THE UNITED STATES WITH SELECTED DEVELOPING COUNTRIES, 1975–79

	Year				
	1975	1976	1977	1978	1979
Country:					
Hong Kong	0.16	0.20	0.24	0.28	0.33
India	.21	.30	.33	.32	.36
Indonesia	.04	.04	.04	.05	.16
Malaysia	.27	.11	.07	.09	.18
Mexico	.17	.17	.13	.11	.25
Singapore	.06	.08	.10	.15	.14
South Korea	.13	.16	.22	.25	.28
Taiwan [1]	.15	.18	.21		

[1] Trade data for Taiwan were unavailable for 1978–79.

Source: Trade data taken from the U.N. Commodity Trade Series D.

TABLE 4.—*Top 5 commodities where PRC exports were similar to the exports of Hong Kong, India, Mexico, and South Korea, 1979*

Commodity description	*SITC*
Hong Kong:	
Clothing of textile fabric not knitted or crocheted	8411
Clothing and accessories, knitted or crocheted	8414
Cotton fabrics, woven, grey	6521
Footwear	8510
Special transactions not classifed according to kind	9310
India:	
Clothing of textile fabric not knitted or crocheted	8411
Carpets	6575
Crustacea and molluscs, fresh	0313
Cotton fabrics, woven, grey	6521
Made up articles of textile materials	6569
Mexico:	
Petroleum, crude	3310
Crustacea and molluscs, fresh	0313
Works of art	8960
Clothing of textile fabric, not knitted or crocheted	8411
Special transactions not classified according to kind	9310
South Korea:	
Clothing of textile fabric, not knitted or crocheted	8411
Clothing and accessories, knitted or crocheted	8414
Footwear	8510
Nails, tacks, staples, spikes, etc.	6941
Special transactions not classified according to kind	9310

B. Sectorial Effects of Tariff Reductions on U.S. Imports and Employment

There are a number of industries in the U.S. economy which have experienced reductions in job opportunities over the last decade due to the expansion and liberalization of international trade. The normalization of economic and commercial relations between the United States and the PRC, and the resulting expansion of trade may cause a further reduction in employment opportunities in these trade-sensitive industries. This section first identifies the specific U.S. industries where employment opportunities have been adversely affected by trade in the past. The leading tariff-sensitive items in U.S.-PRC trade are then identified and compared to these domestic trade-sensitive industries to determine the extent to which the adverse effects of normalized trade relations with the PRC will be concentrated on trade-sensitive U.S. industries. The characteristics of workers in the tariff-sensitive industries who are likely to experience a reduction in employment opportunities are then described. The final part of this section discusses the potential for future trade with the PRC to have adverse effects on domestic industries in which there is currently little or no trade with the PRC.

(I) IMPORT-SENSITIVE INDUSTRIES IN THE U.S. ECONOMY

Various quantitative indicators of the effects of imports on domestic employment opportunities in 4-digit input-output industries have been used to characterize certain U.S. industries as trade-sensitive. These indicators are: (1) a finding of injury by the U.S. International Trade Commission (USITC) in a petition for relief from imports under the escape clause (Section 201) provision of the Trade Act of 1974; (2) receipt of substantial amounts of Trade Adjustment Assistance (TAA) benefits under the 1974 Trade Act; (3) a significant loss in employment opportunities related to international trade over the period 1964-75; or (4) a relatively large loss of employment opportunities as a result of the tariff reductions agreed to in the Tokyo Round of the Multilateral Trade Negotiations.[37]

Table 5 lists the 44 industries which were identified as trade-sensitive on the basis of the measures described above. Although these measures are to some extent arbitrary, they do capture a broad range of industries which can be considered to have been adversely affected by expanded trade and which, in some cases, have experienced employment dislocations.[38] The industries include those which employ relatively low-skill, low-wage workers which can be expected to compete with LDC producers, including the PRC. The table also lists industries which do not fall into that category, such as iron and steel and automobile manufacturing, which have been largely affected by competition with developed countries.

TABLE 5.—*U.S. trade-sensitive manufacturing industries*

Industry	*4-digit—I/O*
Canned fruits and vegetables	1409
Vegetable oil mills, n.e.c	1426
Food preparations, n.e.c	1432
Broadwoven fabrics	1601

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[37] The criteria were based on the following sources: (1) Industries for which a positive finding of injury has been made are given in the annual report U.S. International Trade Commission, Operation of the Trade Agreements Program, Publication 848 (Washington: USITC, 1977) and other volumes; (2) The industry distribution of receipt of TAA benefits is available from the Office of Trade Adjustment Assistance, U.S. Department of Labor, Washington, D.C.; (3) The principal industries adversely affected by trade over the period 1964-75 are listed in Aho and Orr (1981); (4) The principal industries losing employment opportunities due to the Tokyo Round tariff reductions are listed in Bayard and Orr (1979).

[38] A somewhat narrower classification of sensitive industries, those petitioning for import relief, was used by Taylor and Lamb, (1979) in their study of communist country exports in import sensitive sectors.

TABLE 5.—*U.S. trade-sensitive manufacturing industries*—Continued

Industry	4-digit—I/O
Yarn mills and finishing of textiles, n.e.c	1603
Knit fabric mills	1803
Apparel	1804
Fabricated textiles, n.e.c	1903
Wood products, n.e.c	2009
Wood household furniture	2201
Metal household furniture	2203
Furniture and fixtures, n.e.c	2307
Paper products, n.e.c	2407
Paperboard	2500
Tires and inner tubes	3201
Rubber footwear	3202
Leather products	3300
Nonrubber footwear	3402
Other leather products	3403
Glass, glass products	3501
Ceramic wall and floor tile	3603
Food utensils, pottery	3607
Pottery products, n.e.c	3609
Cut stone and stone products	3615
Blast furnaces and basic steel products	3701
Primary copper	3801
Primary nonferrous metals	3805
Metal barrels	3902
Screw machine products	4101
Hardware, n.e.c	4203
Miscellaneous wire products	4205
Fabricated metal products, n.e.c	4211
Machine tools, metal cutting types	4701
Textile machinery	4802
Office machines, n.e.c	5104
Radio and TV receiving sets	5601
Radio and TV communication equipment	5604
Electronic components	5701
Autos and parts	5903
Motorcycles, bicycles, and parts	6105
Jewelry, including costume and silverware	6401
Sporting and athletic goods, n.e.c	6404
Artificial flowers	6406
Miscellaneous manufacturers, n.e.c	6412

(II) INDUSTRIES MOST LIKELY TO BE AFFECTED BY MFN OR GSP TARIFF REDUCTIONS

Table 6 presents the industries (4-digit I/O industries) in each of the broad sectorial aggregates used in Table 2 in which imports are likely to increase substantially as a result of MFN or GSP tariff reductions on PRC goods. Of the 20 industries listed in Table 6, 15 were also included in Table 5 as having been import-sensitive in the past. (These industries are indicated in the table by an asterisk.) The 20 industries listed in Table 6 accounted for approximately $296 million, or 56 percent of total 1979 U.S. imports from the PRC.

The trade and employment effect of tariff reductions on the tariff-sensitive industries, grouped together by broad industrial sectors, is discussed below.

TABLE 6.—INDUSTRIES MOST LIKELY TO BE AFFECTED BY MFN OR GSP TARIFF REDUCTIONS

[In thousands of dollars and man-years]

I/O and industry	1979 imports from PRC [1]	Changes attributable to MFN				Changes in 1979 imports of PRC goods attributable to GSP	
		Without restraints		With restraints			
		Changes in 1979 imports	Reduction in employment opportunities	Changes in 1979 imports	Reduction in employment opportunities	Ignoring competitive need limits	Considering competitive need limits
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Textiles and apparel	184,100	88,202	4,071	22,437	1,029	3,198	853
1601 Broadwoven fabric mills [1]	25,553	2,920	951	2,920	321	280	280
1603 Yarn mills [1]	1,054	294	202	294	88	162	96
1701 Floor coverings	17,804	541	66	541	65	506	2
1804 Apparel [1]	132,802	80,237	2,804	14,472	510	2,143	406
1902 House furnishings	6,887	4,210	48	4,210	45	107	69
Chemicals	52,059	5,446	119	5,446	90	2,155	541
2701 Industrial chemicals	19,546	2,632	80	2,632	54	1,411	134
2704 Miscellaneous chemicals	25,737	1,861	26	1,861	23	335	67
2901 Drugs	6,776	973	13	973	13	409	340
Furniture and wood products	22,769	8,789	190	8,789	189	5,736	2,691
2009 Lumber and wood products [1]	20,762	5,636	134	5,636	133	5,011	1,966
2307 Furniture and fixtures [1]	2,007	3,153	56	3,153	56	725	725
Footwear	13,938	8,822	251	8,822	251	1	1
3202 Rubber footwear [1]	11,652	7,888	209	7,888	209	1	1
3402 Leather footwear [1]	2,286	934	42	934	42	0	0
Food products	8,506	674	8	674	8	125	125
1409 Canned fruits and vegetables [1]	1,690	259	3	259	3	101	101
1432 Food preparations, n.e.c [1]	6,816	415	5	415	5	24	24
Leather products	3,248	1,942	84	1,942	82	91	91
3403 Leather products, n.e.c [1]	3,248	1,942	84	1,942	82	91	91
Ceramic prodcts	2,845	3,300	100	3,300	100	1,631	1,631
3607 Food utensils [1]	1,839	2,062	66	2,062	66	26	26
3609 Pottery products, n.e.c [1]	1,006	1,238	34	1,238	34	1,605	1,605
Other	6,455	6,234	150	6,234	148	4,986	4,147
6401 Jewelry [1]	2,533	2,311	65	2,311	65	2,747	1,911
6406 Feathers, plumes and artificial flowers [1]	2,395	2,941	49	2,941	48	1,476	1,476
6412 Miscellaneous manufacturing [1]	1,527	982	36	982	35	763	760

[1] Import-sensitive industry listed in table 5.

Textiles and Apparel

Textiles and apparel was the largest category of manufactured products imported from the PRC in 1979. Apparel imports (I/O 1804) were $133 million. Imports of broadwoven fabrics (I/O 1601), floor coverings (I/O 1701), house furnishings (I/O 1902) and textile yarns (I/O 1603) were also significant. These five categories together accounted for $184 million, or 35 percent of total U.S. imports from the PRC in 1979. Using the criteria discussed earlier, apparel, broadwoven fabrics and textile yarns were identified as highly import-sensitive.

According to the estimates, had PRC imports been dutied at MFN rates, U.S. imports in the five catetories mentioned above would have exceeded actual imports in 1979 by $88.2 million, or 48 percent. Apparel imports alone would have exceeded actual import levels by $80 million, or 60 percent. These increases in imports would have translated into the loss of over 4,000 job opportunities in the textiles/apparel sector and 2,800 job opportunities in the apparel sector alone. GSP tariff treatment would have increased textile and apparel imports by $3.2 million, or about 2 percent.

The predicted increases in U.S. imports from the PRC do not take into account the U.S. textile program geared to the orderly growth of imports and the prevention of market disruption, or the competitive need exclusions on GSP duty-free treatment.[39] Negotiations with the PRC on a bilateral agreement to facilitate the orderly growth of U.S.-PRC textile and apparel trade and avoid market disruption began informally in late 1978. Several formal negotiating sessions held during the first half of 1979 failed to resolve outstanding differences between the two sides.[40]

In view of the lack of progress in the negotiations and the rising volume of uncontrolled PRC apparel imports, the United States imposed unilateral quotas on seven categories of PRC apparel imports for a twelve-month period under the authority of Section 204 of the Agricultural Act of 1956, as amended. Five of the restraints, on cotton gloves,[41] women's cotton knit shirts and blouses, men's and boys' woven cotton shirts, male/female cotton trousers, and male/female man-made fiber sweaters, were imposed effective June 1, 1979, and the other two, on cotton blouses and women's man-made fiber coats, became effective October 31, 1979 (see Table 7). In determining the quota level, imports from the PRC during a representative twelve-month period were used: for the quotas imposed effective June 1 the period used was March 1, 1978 to February 28, 1979; for the quotas effective October 31, the representative period was August 1, 1978 to July 31, 1979. With the signature of a three-year bilateral textile agreement in September 1980, the unilateral restraints for six of the seven categories were lifted and replaced with agreed import levels for each of the three years covered by the agreement.[42]

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[39] The United States is a signatory of the Multifiber Arrangement (MFA), a multilateral agreement covering trade in textiles and apparel products made of cotton, wool and man-made fibers. The MFA became effective in 1974 for a three-year period and was later extended until December 31, 1981. The United States currently has bilateral agreements regulating textiles and apparel trade with 22 supplying countries, and consultative mechanisms with 11 others, all drawn in conformity with the MFA. The PRC is not a signatory to the MFA.

[40] See. e.g., H. Reiter Webb, Jr. (1980).

[41] Even before the resumption of diplomatic relations between the United States and the PRC, domestic manufacturers were concerned about rising imports of cotton work gloves from the PRC. In December 1977 a group of domestic producers filed a petition for import relief under Section 406 of the Trade Act of 1974 alleging that market disruption existed as a result of increased imports of cotton work gloves from the PRC. Imports of these articles from the PRC, almost negligible during 1972–75, had risen abruptly in 1976 to account for about 19 percent of U.S. imports. The U.S. International Trade Commission determined in March 1978 that such increased imports were not disrupting the U.S. market. See U.S. International Trade Commission, Certain Gloves from the People's Republic of China, Publication 867 (Washington: USITC, March 1978).

[42] The agreement did not provide for a limit on imports of man-made fiber coats since the PRC filled only 16.3 percent of the unilateral quota. Mutually agreed import restraint levels for

Continued

TABLE 7.—IMPORT LEVELS UNDER UNILATERAL QUOTAS AND UNDER THE UNITED STATES–PRC TEXTILE AGREEMENT

Category and Description [1]	Unilateral quota	Bilateral agreement: 1st agreement year	2d agreement year	3d agreement year
331 Cotton gloves (dozen pair)	2,946,000	3,213,600	3,310,008	3,409,308
339 Women's cotton knit shirts and blouses (dozen)	535,659	720,000	912,000	865,280
340 Men's and boys' woven cotton shirts (dozen)	354,613	540,000	561,600	584,064
341 Cotton blouses (dozen)	266,196	381,300	455,100	443,456
347/348 Cotton trousers, male/female (dozen)	1,088,632	1,440,000	1,824,000	1,730,560
635 Women's man-made fiber coats (dozen)	110,551	(2)	(2)	(2)
645/646 Man-made fiber sweaters male/female (dozen)	334,834	550,000	566,500	583,495

[1] These are special categories defined by the United States for monitoring imports of textile and apparel products and administering the United States textile trade agreement programs. For a concordance between the textile and apparel categories and seven-digit TSUSA items, see U.S. Department of Commerce, Industry and Trade Administration, Office of Textiles, Correlation: Textile and Apparel Categories with Tariff Schedules of the United States Annotated (Washington: U.S. Government Printing Office, January 1978).

[2] No specific limit set.

Sources: For unilateral quotas, Federal Register 44:110 (June 6, 1979), p. 32433 and idem, 44:212 (October 31, 1979), p. 62555. For bilateral agreement, "United States and China Sign Bilateral Textile Agreement," Department of State Press Release No. 257 (September 17, 1980).

The effect of the import restraints on selected PRC apparel shipments is to curb potential growth by limiting the quantity of imports which may enter the United States in a given period to the same level reached in an earlier period. Consideration of these restraints is important in estimating the real impact of tariff reductions since they act to prevent predicted increases in imports from occurring. As an illustration, we have introduced import restraints on the seven categories listed in Table 7 into our analysis in order to gauge the extent to which they would moderate the estimated import and employment impact of MFN tariff reductions.

For the sake of simplifying the simulations, it has been assumed that import restraints in the seven apparel categories were imposed for the entire year 1979 and, further, that the restraint levels were set at the actual volume of 1979 imports. That is, we have assumed that the restraints would have prevented increased imports resulting from tariff cuts but would not have reduced actual 1979 imports. While reduction in U.S. tariffs to MFN rates would have increased imports of PRC apparel products by $80 million, the restraints would have prevented the realization of approximately $65 million worth of such imports. The evidence in Table 6 (columns 3 and 5) suggests that the import restraints are an effective tool in reducing potential employment losses in the textile/apparel industry. The apparel manufacturing industry, which according to the unrestrained simulations would have lost 2800 job opportunities, would suffer losses of 500 job opportunities with import restraints. Because the apparel sector purchases materials from other sectors, the restraints on apparel imports also affect output and employment in other sectors, such as textiles. Job losses in the textile and apparel industries, which were estimated

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the first agreement year are on average about 40 percent higher than previous unilateral restraint levels; in general, second and third year levels take into account growth and are more liberal. The text of the agreement is given in "United States and China Sign Bilateral Textile Agreement," Department of State Press Release No. 257 (September 17, 1980). Since the agreement went into effect, the United States has requested consultations to establish import limits for four additional categories in which imports have surged. The four categories are wool sweaters, men's cotton coats, women's cotton coats, and men's cotton knit shirts.

at about 4000, would be reduced to about 1000 with the import restraints.

Introduction of competitive need limits also curbs the potential imports of PRC textiles and apparel which would result from GSP duty-free imports. (Articles covered by the MFA do not receive GSP duty-free treatment.) As shown in Table 6, columns 6 and 7, competitive need criteria would have curbed increases in apparel imports generated by GSP duty-free treatment from $2.1 million to $406,000, and for floor covering from $506,000 to $2,000. For the five textile and apparel industries, competitive need limits would have curbed potential increases in imports resulting from GSP from $3.2 million to $853,000.

Chemicals

In 1979, U.S. imports from the PRC of industrial chemicals (I/O 2701), miscellaneous chemical products (I/O 2704) and drugs (I/O 2901) amounted to approximately $52 million. Among industrial chemicals, leading imported products were ammonium molybdate, antimony oxide, potassium permanganate and barium chloride. The bulk of imports of miscellaneous chemical products was accounted for by fireworks, turpentine, inedible gelatin, and distilled and essential oils. Menthol, natural drugs, and natural alkaloids were the leading imported drug products. Although these categories are not considered import-sensitive based on the criteria presented above, U.S. manufacturers have complained that some PRC chemical products have been sold in the U.S. market at less than their fair value.[43]

According to our estimates, had the PRC enjoyed MFN status in 1979, U.S. imports of these chemical products would have exceeded actual imports by about $5.5 million, or 10 percent. Employment opportunities would have been reduced by approximately 120. If restraints on apparel imports are considered, employment opportunity losses attributed to MFN tariff treatment are reduced from 120 to 90. GSP duty-free treatment of eligible imports would have generated additional imports of approximately $2.2 million, or 4 percent. The impact of GSP duty-free treatment is relatively small since the key miscellaneous chemical products shipped by the PRC in 1979 (fireworks, inedible gelatin and most distilled and essential oils) are not extended GSP duty-free treatment. Moreover, the 50 percent competitive need rule would have curtailed duty-free imports by approximately three-quarters, so that increased import demand attributable to GSP would have been of the order of $541,000, or 1 percent of actual 1979 trade.

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[43] In response to a complaint filed by a U.S. firm, the U.S. International Trade Commission ruled in July 1980 that there was reasonable indication that imports of natural menthol from the PRC, allegedly sold at less than fair value (LTFV), were materially injuring or threatening a domestic industry. See U.S. International Trade Commission, Menthol from Japan and the People's Republic of China, Publication 1087 (Washington: USITC, July 1980). In early 1981, the U.S. Department of Commerce ruled that natural menthol from the PRC was being sold in the U.S. at LTFV and estimated a dumping margin of 13.5 percent. Federal Register 46:9 (January 14, 1981), pp 3258–61. However, as a result of a final investigation, in June 1981 the USITC changed its earlier determination and ruled that natural menthol imports from the PRC were not materially injuring a domestic industry, thereby terminating the case. See U.S. International Trade Commission, Menthol from the People's Republic of China, Publication 1151 (Washington: USITC, June 1981). Charges of Chinese dumping of chemical products have not been limited to menthol. In response to a Federal Register request for information on the probable economic effect on domestic industries of designating the PRC as a beneficiary under the U.S. program, an official of the Chemical Products Corporation of Cartersville, Georgia, suggested that several products from the PRC were being sold in the U.S. at LTFV and indicated that a petition for a dumping investigation against the PRC on barium chloride was under consideration. Letter dated March 4, 1981 in Public Docket, U.S. International Trade Commission, Investigation 332-123.

Furniture and Wood Products

Furniture and wood product imports from the PRC in 1979 in two import-sensitive categories amounted to about $22.8 million. Furniture and fixtures (I/O 2307) imports, primarily furniture made from unspun vegetable materials, were valued at approximately $2 million. More important were imports of lumber and wood products (I/O 2009), which amounted to approximately $20.8 million. The leading lumber and wood products imported from the PRC in 1979 were baskets of bamboo, willow, and rattan, other household articles made from unspun vegetable fibers, and wood blinds. Wooden clothespins imports from the PRC amounted only to $21,000 in 1979.

The estimates suggest that had PRC imports been dutied at MFN tariff rates in 1979, furniture and wood product imports would have exceeded actual values by about $8.8 million, or 39 percent. Approximately 190 employment opportunities would have been lost in this industry.[44] Further, had these imports been subject to GSP duty-free treatment, imports would have increased by an additional $5.7 million, or 25 percent. The competitive need exclusions on lumber and wood product imports would have reduced the increase in imports attributable to GSP duty-free treatment by more than one-half, to $2.7 million, or 12 percent.

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[44] In estimating the trade effects of tariff reductions, potential restrictions on imports of clothespins from the PRC have not been considered for the following reasons: 1) the three-year global quotas on clothespins have not been filled in either of the first two quota years (for the first quota year, February 1979-February 1980, 71.4 percent of the quota was filled; for the second year, February 1980 to February 1981, 85.8 percent of the quota was filled); 2) the share of the U.S. clothespins import market held by the PRC has fallen precipitously, from around 25 percent in 1977 to 1.7 percent during the first quota year and around 3.6 percent in the second quota year; and 3) in view of the above, the very small estimated unrestricted 1979 import change of $3,000 resulting from MFN extension could have been easily accommodated in the quotas. Clothespins are not extended GSP duty-free treatment.

The history of the clothespins quota, in which the PRC played a prominent role, is worth recounting. In May 1978, the Clothespin and Veneer Products Association filed a petition for import relief on behalf of domestic clothespins manufacturers under Section 406 of the Trade Act of 1974. The petitioners alleged that clothespins imports from three non-market economies (the People's Republic of China, Poland and Romania) were causing market disruption with respect to like products produced by the domestic industry. In August 1978, the U.S. International Trade Commission reported to the President that clothespins imported from the People's Republic of China were creating market disruption, while those imported from Poland and Romania were not. The Commissioners recommended that the President grant import relief in the form of 5-year quotas on clothespin imports from the PRC. U.S. International Trade Commission, Clothespins from the People's Republic of China, the Polish People's Republic and the Socialist Republic of Romania, Publication 902 (Washington: USITC, 1979). After reviewing the Commissioners' recommendation, the President determined in October 1978 that the provision of import relief would not be in the national economic interest. The President's determination appears in Federal Register 43:192 (October 3, 1978), p. 45547.

Meanwhile, in July 1978, the USITC instituted, on its own motion, an investigation under Section 201 of the Trade Act of 1974 (escape clause provision) to determine whether imports of clothespins from any source were injuring or threatening a domestic industry. In December 1978, the Commissioners determined that serious injury to the domestic industry existed and recommended import relief in the form of a 5-year global quota on specific types of wood and plastic spring clothespins. U.S. International Trade Commission, Clothespins, Publication 933 (Washington: USITC, 1979.) In February 1979, the President granted import relief in the form of three-year global quotas. The Presidential proclamation is reproduced in Federal Register 44:39 (February 26, 1979), pp. 10973–10975.

Footwear

Both the nonrubber and rubber segments of the domestic footwear industry have been adversely affected by imports in the past. In 1979 U.S. footwear imports from the PRC amounted to almost $14 million. Rubber footwear (I/O 3202) imports of approximately $11.7 million were composed almost exclusively of Oxford-height men's and women's shoes. Imports of thonged rubber sandals (zoris) amounted to only $2,000 in 1979. Nonrubber footwear (I/O 3402) imports of about $2.3 million were primarily accounted for by men's and women's cement-processed footwear and men's workshoes.

Our estimates indicate that MFN tariff treatment of PRC imports during 1979 would have generated an additional $8.8 million worth of footwear imports, an increase of 63 percent. Imports of this magnitude would have eliminated 251 employment opportunities in the industry. Duty-free treatment of GSP-eligible imports would have had a negligible ($1,000) effect on imports, because rubber and leather footwear imports, with the exception of zoris, are not eligible for GSP duty-free treatment.

Food Products

U.S. imports of food products from the PRC in 1979 in two important categories were valued at $8.5 million. Imports of food preparations (I/O 1432), primarily of honey, were valued at $6.8 million. Also significant were imports of sugar, bean cakes, seaweeds, shelled peanuts and vinegar. Imports of canned fruits and vegetables (I/O 1409), primarily canned water chestnuts, mandarin oranges, and mushrooms, accounted for $1.7 million in 1979.

According to our estimates, reduction of tariffs to MFN rates on food product imports from the PRC would have led to an increase in 1979 imports of $674,000, or about 8 percent, and a reduction of 8 employment opportunities in these sectors. Particularly important would have been import increases in two import-sensitive products, canned mushrooms[45] (36 percent) and honey[46] (6 percent). Duty-free treatment of GSP-eligible imports in the two categories would have increased imports by an additional $125,000, or 1 percent. It should be noted that honey, seaweeds, canned mushrooms and mandarin oranges, and shelled peanuts, some of the leading PRC food products shipped to the United States in 1979, are not extended GSP duty-free treatment.

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[45] In March 1980, the American Mushroom Institute filed a petition with the U.S. International Trade Commission seeking import relief under Section 201 of the Trade Act of 1974 with respect to imports of canned mushrooms. This petition was the latest in a series of unsuccessful efforts since 1964 by the canned mushroom industry to obtain relief from imports. In August 1980, the USITC determined that canned mushrooms were being imported in such large quantities as to be a substanial cause or threat of injury and recommended relief in the form of three-year quotas. During the early part of the period analyzed by the USITC, imports from the PRC were negligible. For January-May 1980, however, a period which includes four months of MFN treatment, the PRC's share of imports rose sharply to 5.6 percent. See U.S. International Trade Commission, Mushrooms, Publication 1089 (Washington: USITC, 1980). Acting on the USITC recommendation, the President granted relief for the industry, but selected higher tariffs rather than quotas. Effective November 1, 1980, the MFN tariff on imported mushrooms was raised from 13.2 percent AVE to 33, 28 and 23 percent AVE for each of the three years. See Federal Register 45:207 (October 23, 1980), p. 70361. These higher tariffs tend to erase the import-creating impact for the PRC of lower MFN tariffs on mushrooms.

[46] In June 1976, the U.S. International Trade Commission reported that honey was being imported in such quantities as to be a substantial cause of the threat of serious injury to the domestic industry and recommended relief in the form of tariff-rate quotas to be in effect until December 31, 1980. See U.S. International Trade Commission, Honey (Washington: USITC, 1976). However, in August 1976, the President determined that import relief was not in the national economic interest. The Presidential memorandum is reproduced in Federal Register 41:171 (September 1, 1976), pp. 36787–8.

Leather Products

U.S. imports of miscellaneous leather products (I/O 3403) in 1979 consisted primarily of leather gloves. Other important products included in this import-sensitive category were luggage, handbags and flat goods of leather or textile materials, and wooden boxes, either unlined or lined with textile fabrics.

In 1979, imports from the PRC in I/O 3403 were valued at about $3.2 million. Our analysis indicates that had miscellaneous leather products imports from the PRC been dutied at MFN rates in 1979, they would have exceeded actual values by $1.9 million, or 60 percent, and reduced employment opportunities in the industry by around 80. GSP duty-free treatment would have added $91,000 worth of imports, or 3 percent.

Ceramic Products

In 1979, the PRC shipped to the United States ceramic products valued at approximately $2.8 million. Imports of food utensils (I/O 3607), consisting primarily of household and restaurant ceramic tableware and earthenware, were valued at $1.8 million. Imports of other pottery products (I/O 3609), such as ash trays and household decorative articles, were valued at about $1 million.

Representatives from the ceramic industry and unions recently appeared before the U.S. International Trade Commission to argue that their industry was adversely affected by imports from the PRC and would be further injured if the PRC were granted eligibility in the U.S. GSP program.[47] Our simulations suggest that their concerns may be justified.

Our analysis indicates that had ceramic products been dutied at MFN rates in 1979, U.S. imports would have exceeded actual imports by $3.3 million, or 116 percent, and 100 employment opportunities would have been lost. This more-than-doubling of imports would have resulted from the combination of substantial tariff differentials between column 1 and column 2 rates and a high elasticity of import demand. Elimination of duties on GSP-eligible items would have added another $1.6 million-worth of imports, or 57 percent. Virtually the entire (98 percent) increase in imports brought about by the GSP duty elimination would have occurred in the pottery category (I/O 3609) since, with minor exceptions, ceramic food utensils are not eligible for duty-free treatment under the GSP program.

Jewelry

Jewelry (I/O 6401) imports from the PRC in 1979 of approximately $2.5 million consisted primarily of precious and semiprecious stones, gold-plated household wares, gold rope necklaces, and other personal jewelry. Stainless steel flatware imports were relatively insignificant, amounting to approximately $35,000 in that year. With the exception of stainless steel flatware, products in this category do not have a high degree of import sensitivity.

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[47] See statements before the USITC on behalf of the Stone, Glass and Clay Coordinating Committee, the American Dinnerware Emergency Committee, and the American Restaurant China Council, Investigation 332-123, April 22, 1981.

Our model indicates that MFN tariff treatment of jewelry imports from the PRC in 1979 would have increased imports in this category by $2.3 million, or 91 percent, with a reduction in employment opportunities of 65. Duty-free treatment of GSP-eligible items in 1979 could have increased imports by an additional $208 million, or 108 percent. However, competitive need limitations would have scaled back the increase in imports attributable to GSP to $1.9 million, or 75 percent. For stainless steel flatware, MFN tariff treatment would increase imports by $46,000 or 131 percent and GSP duty-free treatment would generate an additional $50,000 of imports, a 143 percent increase.

Feathers, Plumes and Artificial Flowers

In 1979, total U.S. imports from the PRC of feathers, plumes, and artificial flowers (I/O 6406) were valued at about $2.4 million. Feathers and down imports accounted for roughly 87 percent of the value of imports in this category, and feather dusters for an additional 5 percent.

Had imports from the PRC been subject to MFN duties in 1979, imports during that year would have exceeded actual values by $2.9 million, or 123 percent, and employment opportunities would have contracted by about 50. Duty-free treatment of GSP-eligible imports would have added approximately $1.5 million worth of imports in this category, or 61.6 percent of actual 1979 imports.

Miscellaneous Manufactures

Among the principal imports of miscellaneous manufactures (I/O 6412) from the PRC in 1979 were beads, candies, umbrellas, shell products, human hair, and wigs of human hair. Miscellaneous manufactures' imports in 1979 amounted to approximately $1.5 million.

Results of simulations with our model indicate that MFN tariff treatment of miscellaneous manufactures from the PRC in 1979 would have increased imports by $982,000, or 64 percent. Approximately 35 employment opportunities would have been lost. Duty-free treatment of GSP-eligible items could have added imports of $763,000, or 64 percent.

To summarize the industry results, our analysis suggests that the increases in imports attributable to MFN and GSP tariff reductions on PRC goods are ameliorated by import restraints and GSP competitive need limits. However, this is not the case for ceramic products imports. The domestic ceramic products industry appears to be most vunerable to increased imports due to the tariff cuts.

An examination of the characteristics of workers in the tariff-sensitive industries in Table 6 indicates that systematic differences exist between these workers and the average worker in the manufacturing sector. The average hourly wage rate of workers in these industries (in 1979) was $4.99 compared to $6.69 for the manufacturing sector as a whole.[48]

These industries employed a disproportionately large percentage of females (55.4 percent), than did the manufacturing sector as a whole (29.4 percent), and a slightly larger proportion of minority workers (10.7 percent), compared to the manufacturing average (10.1 percent).[49] Workers in these industries are less likely to be members of a union than the average worker in manufacturing (43.9 percent compared to 50 percent.[50] None of these tariff-sensitive industries can be considered to employ, on average, relatively high-wage workers. Therefore, any costs associated with the reduction of employment opportunities in these tariff-sensitive industries are likely to be borne by workers in the lower-skilled segment of the labor force. Furthermore, since the adverse effects of the tariff reductions on PRC goods tend to be concentrated in industries which are already sensitive to trade the reductions in employment opportunities may affect workers in industries which, in many cases, have already experienced reductions in employment opportunities due to trade.

(III) SECTORS WHICH MAY BE AFFECTED BY IMPORTS FROM THE PRC IN THE FUTURE

The review of the tariff sensitivity of the leading sectors in U.S.-PRC trade was based on the actual pattern of U.S. imports from the PRC in 1979. It is possible that there are certain commodities which the PRC does not currently export to the United States in signficant amounts (because of prohibitive pre-MFN tariffs or other reasons) but which may be exported in large quantities in the near future. It is useful to speculate briefly on the product areas in which imports from the PRC may have an adverse effect in the near future. To do this, we have used the Finger-Kreinin index to focus on the correspondence of PRC exports to France, Germany, Japan and the United Kingdom, with PRC exports to the United States. The basket of PRC exports to these other industrialized countries may be indicative of the basket of products the United States might import from the PRC under a more " normal" trade pattern than prevailed in U.S.-PRC trade in 1979. European and Japanese trade with the PRC may be more normal in the sense that it better reflects PRC comparative advantage, MFN status, and the "getting to know each other" effect.

The results of the similarity index comparison of PRC exports to the United States with PRC exports to the four industrialized countries are presented in Table 8 for 1975-79. The table suggests that in any given year approximately 40 percent of PRC exports to the four industrialized countries and to the United States corresponded to the same categories. The important question raised by Table 8 is, what commodities did the PRC export to Europe and Japan that it did not export to the United States?

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[48] Average hourly wage rates for each industry for 1979 are published in U.S. Department of Labor "Employment and Earnings," vol. 27, No. 3, March 1980. The data are weighted averages using 1976 employment levels as weights.

[49] Data on the demographic composition of employment were taken from U.S. Department of Commerce, "Census of Population, 1970, Subject Reports: Industrial Characteristics" (Washington: U.S. Government Printing Office, 1972).

[50] Data on unionized workers as a percentage of the work force are taken from Freeman and Medoff (1979).

TABLE 8.—SIMILARITY OF PRC EXPORTS TO THE UNITED STATES WITH SELECTED WESTERN EUROPEAN COUNTRIES 1975–79

Country	1975	1976	1977	1978	1979
France	41.8	42.1	47.8	46.5	39.6
West Germany	35.7	44.7	53.0	46.5	39.7
Japan	21.8	25.3	24.8	27.3	43.3
United Kingdom	36.5	40.9	45.3	42.1	33.5

Table 9 lists the top ten commodities for which PRC exports to the United States and to the comparison group were dissimilar in 1979. That is, the 4-digit SITC commodities listed in the table correspond to those categories in which PRC exports to the United States were negligible while those to the four reference countries were substantial. The commodities in the list are primarily food products and raw materials (hydrocarbons, furskins, jute and silk products). Few of these items would be considered sensitive products in the United States.[51] However, there are some manufactured products items on the list which could have an adverse effect on U.S. import-competing industries. Thus, clocks, tools, certain chemicals, paper products, and a number of textile and apparel items appear to be important in the trade of European countries with the PRC and may become more prominent in exports to the United States in the future.

In addition to the results of the similarity index, we have also examined assessments on expected imports from the PRC prepared by industry officials and reviewed fragmentary data on PRC capacity to produce certain products for export. In what follows we use these indicators to discuss several product sectors which may be adversely affected by imports from the PRC in the near future. It should be stressed at the outset that this section is speculative and the evidence presented should be interpreted with caution.

TABLE 9.—*Top 10 commodities where PRC exports to the United States were not similar to PRC exports to other selected industrialized countries, 1979*

Commodity description	SITC
France:	
Aluminum and aluminum alloys, unwrought	6841
Coal	3214
Jute	2640
Groundnut oil	4214
Woven fabrics of artificial fibers	6536
Furskins	6130

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[51] The PRC would not be able to export furskins to the United States. Effective August 31, 1951, the United States prohibited the importation of ermine, fox, kolinsky, marten, mink, muskrat and weasel furskins, (the so-called "seven deadly skins") dressed or undressed, produced in the PRC. See U.S. International Trade Commission, "Tariff Schedules of the United States Annotated (1981)," Publication 1111 (Washington: USITC, 1980), The prohibition, contained in sec. 11 of the Trade Agreements Extension Act of 1951, has also been in effect since Jan. 1, 1952 for the same products originating from the U.S.S.R.

TABLE 9.—*Top 10 commodities where PRC exports to the United States were not similar to PRC exports to other selected industrialized countries, 1979*—Continued

Commodity description	*SITC*
Leather	6119
Fur clothing	8420
Clocks	8642
Printed cotton fabrics	6522
West Germany:	
Furskins	6130
Furskins, undressed	2120
Tapestries	6577
Hand tools	6952
Green groundnuts	2211
Woven fabrics of artificial fibers	6536
Fresh or dried vegetable products	0548
Frozen vegetables	0546
Cereals, unmilled	0459
Cocoa butter and cocoa paste	0723
Japan:	
Quartz, mica, feldspar, fluorspan	2765
Fish, salted, dried, or smoked	0312
Hydrocarbons	5121
Furskins	6130
Beans, peas, lentils	0542
Green groundnuts	2211
Frozen vegetables	0546
Bones, ivory, horns, hoofs	2911
Cereals, unmilled	0459
Soya Beans	2214
United Kingdom:	
Furskins	6130
Chemical products and preparations	5999
Sheep's and lamb's wool	2621
Machine-made paper and paperboard	6415
Fresh or dried vegetable products	0548
Nitrogen-function compounds	5127
Cereals, unmilled	0459
Hay and fodder, green or dry	0811
Sheep's and lamb's wool, degreased	2622
True hemp and true hemptow and waste	2652

Bicycles and parts.—The bicycles and parts industry (I/O 6105) has been sensitive to imports in the past (the industry is listed as a sensitive sector in Table 3). However, our simulations did not identify this industry as sensitive to MFN or GSP tariff reductions primarily because imports to date have been very small. Nevertheless, there is little question that the PRC has the potential for substantially increasing its shipments to the United States. As a country where bicycles are a common mode of transportation, the PRC appears to have the capacity to produce bicycles for export on a large scale. There is some evidence that, in preparation for developing an export market, the Chinese have begun to style their products to compete in Western Europe and the United States. The Bicycle Manufacturers Association of America recently testified before the USITC about its concerns regarding potential imports from the

PRC, particularly if complete bicycles were made eligible for GSP duty-free treatment.[52]

Stainless steel flatware.—As is discussed in the previous section, U.S. imports of stainless steel flatware from the PRC in 1979 amounted to only $35,000. Although these imports were quite sensitive to tariff reductions (extension of MFN tariff would have increased imports by 131 percent; GSP duty-free treatment would have generated an additional 151 percent increase in imports), the overall impact of imports from the PRC was deemed to be very small in view of the insignificant trade levels involved.

However, according to press reports, over the next five years the PRC plans to increase its production capacity of stainless steel flatware and to triple its 1979 volume of exports to the United States.[53] Such an increase could have a negative impact on the domestic flatware industry, an industry which has been adversely affected by imports in the past (see Table 3) and which received import relief in the 1960s and in the early 1970s.[54]

Electronic products: The PRC has reportedly entered into several joint ventures with foreign companies to produce electronic products. Over the next few years, electronic components and domestic electronic products produced by these enterprises may return to the investing countries, including the United States. The Electronic Industries Association has testified in opposition to designating the PRC as beneficiary for the U.S. GSP program, arguing that such a move might further encourage the PRC to enter into joint ventures in the electronic products industry.[55]

Industrial fasteners.—Our simulations, based on 1979 data, did not identify the industrial fasteners industry as one which would be sensitive to tariff reductions on PRC imports. Several factors are responsible for this. First, in comparison with other sectors, non-MFN tariff rates for fasteners are generally low (for instance, 3 percent *ad valorem* for iron washers, 4.3 percent for machine screws, and about 16 percent for bolts and nuts) and therefore differences between MFN and non-MFN rates are small. Second, escape clause relief granted to the industry in early 1978, in the form of a three-year increase in MFN tariffs for iron or steel bolts, nuts and large screws, further eroded the difference between MFN and non-MFN rates.[56] Third, as a result of the relief action, nuts and bolts were removed from the list of GSP duty-free eligible products.[57] Significant differences between MFN and non-MFN rates may develop, however, should relief not be renewed after it expires on January 5, 1982, since tariffs will revert to lower pre-relief MFN levels and items may be replaced on the GSP-eligible list.[58]

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[52] Statement before the U.S. International Trade Commission on behalf of the Bicycle Manufacturers Association of America, Investigation 332-123, Apr. 22, 1981.

[53] Lawrence Fairhall, "Chinese Flatware May Impact Market," The Journal of Commerce (Dec. 29, 1980), pp. 1, 27.

[54] The stainless steel flatware industry received import relief in the form of a tariff-rate quota from November 1959 through October 1967 and from August 1971 through September 1976. In May 1978, the USITC found that the industry was being injured by imports and recommended that relief be provided in the form of 3-year tariff-rate quotas. See U.S. International Trade Commission, "Stainless Steel Table Flatware," Publication 884 (Washington: USITC, 1978). However, the President denied relief for the industry on the grounds that it would not be in the national economic interest. The Presidential decision is in Weekly Compilation of Presidential Papers, (June 30, 1978), pp. 1215–1216.

[55] Statement before the USITC on behalf of the Electronic Industries Association, Investigation 332-123, Apr. 22, 1981.

[56] For a report on the injury investigation, findings and relief recommendation, see U.S. International Trade Commission, Bolts, Nuts and Large Screws of Iron or Steel, Publication 847 (Washington: USITC, 1977). The Presidential proclamation of relief appears in the Federal Register 44:5 (January 8, 1979), pp. 1697–1699.

V. SUMMARY AND CONCLUSIONS

The purpose of this study was to determine the impact on U.S. imports and employment of normalized U.S.-PRC trade relations. The study presents both aggregate and industry-specific estimates of the impact on U.S. imports and employment of granting the PRC both MFN and GSP status during 1979. This was done, given some restrictive assumptions, by estimating the amount by which U.S. imports from the PRC would have exceeded their actual 1979 values as a result of tariff reductions associated with MFN and GSP treatment.

The estimates are based on an elasticity approach. A basic assumption underlying the model is that the supply of PRC exports is perfectly elastic. The resulting estimates pertain to total trade expansion. That is, they include both trade creation and trade diversion. In the absence of reliable estimates of the elasticity of substitution between imports from the PRC and imports from other sources, and between imports from the PRC and domestic production, it is assumed that the increased imports from the PRC displace domestic goods on a dollar-for-dollar basis.

The results suggest that in 1979, U.S. imports from the PRC would have exceeded actual imports by approximately $134 million, or 25 percent, had PRC imports been dutied at MFN rates throughout the year. The industries most affected include ceramic products, footwear and textiles and apparel. This translates into a loss of approximately 8600 employment opportunities in the United States. The increased imports in the textile and apparel industry alone would account for approximately 4600 fewer employment opportunities. Had the PRC also enjoyed country-beneficiary status under the U.S. GSP program during 1979, U.S. imports from the PRC would have exceeded actual and MFN imports by 22.2 million, or 4.2 percent. For the ceramic products industry, additional imports of approximately 48 percent of actual 1979 trade would have been generated by GSP. For the furniture and wood products industry the increase would have been 25 percent.

The employment estimates resulting from MFN and GSP status presented in this paper are job opportunities, and are not necessarily changes in actual employment. Normal industry growth, labor force turnover and increased exports to the PRC may offset job opportunity losses in many industries.

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[57] Representatives of the industrial fasteners industry recent appeared before the USITC to oppose extending GSP benefits to the PRC. See statements on behalf of the Industrial Fasteners Institute and Wrought Washer Manufacturing Company, Investigation 332-123, April 22, 1981.

[58] It should be noted that on June 30, 1981, the United States Fasteners Manufacturing Group, the United Steelworkers of America, the International Association of Machinists and Aerospace Workers, the United Automobile, Aerospace and Agricultural Implement Workers of America and the Industrial Union Department of the AFL-CIO petitioned the U.S. International Trade Commission under section 203(i)(3) of the Trade Act of 1974 to advise the President of its judgment of the probable economic effect of terminating relief.

The import and employment estimates are upper-bound estimates because they ignore several factors which might prevent imports from increasing. The most notable exceptions are import restraints on textiles and apparel and competitive need criteria which limit certain items under the GSP program. If we incorporate the quantitative limits on PRC apparel exports, the 1979 trade expansion due to MFN becomes $68 million or 12.9 percent of 1979 trade and the employment effect drops from 8600 to 3740 job opportunities. Introduction of the competitive need limits on GSP imports reduces trade expansion to $14.2 million or 2.7 percent of 1979 trade.

In order to estimate the potential for PRC exports to the United States to displace third country exports, an index developed by Finger and Kreinin is used to measure the similarity of PRC exports to the United States to exports of other LDCs exports to the U.S. market. The rationale behind the use of the index is that the greater the similarity in the baskets of goods exported to the United States from the PRC and other countries, the greater is the probability that PRC goods will displace other countries' exports to the United States. A major problem in utilizing the similarity index, however, was that it was not possible to compare PRC and other countries' exports based on "systemic similarity" or MFN status. Despite these drawbacks, we believe the similarity index can provide considerable insight into the countries and commodities which may be displaced by "normal" U.S.-PRC trade.

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RECENT DEVELOPMENTS IN CHINA'S FOREIGN TRADE PRACTICES, 1978-81

By Liliana B. Monk and A. Jackson Rich*

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I. INTRODUCTION: RECENT ECONOMIC POLICIES

A. Post-Mao Modernization

The modernization plan that the Chinese leadership announced in February 1978 included foreign involvement and participation in the form of equipment, machinery, technology imports and technical services. This ambitious plan proposed 120 major projects as the centerpiece of a rapid, heavy industrial development program. These projects required advanced technologies and equipment available only in the West. Thus, from its inception, the blueprint for development intricately linked modernization and foreign trade.

Since this article was drafted, the People's Republic of China has introduced a program of comprehensive government reorganization that will reach down to provincial and municipal levels. One of the most significant changes of this program has been the realignment of the foreign trade structure. A new Ministry of Foreign Economic Relations and Trade (MFERT) has been created to formulate trade policy. This new Ministry has absorbed the functions of the former Ministry of Foreign Trade, the Ministry for Economic Relations with Foreign Countries, and the Import-Export Commission. Preliminary reports indicate that the MFERT will not alter basic foreign trade decentralization directions and practices. Despite the extensive government reorganization now under way, the authors believe that the PRC will continue with its trade decentralization program along the lines begun during the 1979–81 period described below.

The reliance on foreign investment for development required relaxing or redefining ideological and fiscal barriers to large scale foreign participation and involvement in China. For example, Chinese leaders would have to modify their long standing ideological aversion to foreign investment. The need for new sources of foreign exchange prompted the leadership to modify their strong opposition to long-term, low cost loans. In early 1978, Chinese leaders also began to promote more innovative methods of foreign trade, particularly compensation trade, countertrade and some types of joint ventures. Efforts were made to increase overseas remittances and invisible earnings, and tourism was targeted as a priority industry.

Another catalyst for expansion of the economy and foreign trade was normalization of relations with the United States, announced on December 15, 1978 and implemented on January 1, 1979. This led to a tidal wave of American firms seeking business opportunities with China, although many large firms had been doing business there since the reopening of relations in February 1972.

B. Readjustment

China's expansive economic policy of early 1978 immediately ran into difficulties when the leadership realized later that year that China could neither afford nor manage such a program. Nonetheless, even as the leadership was reassessing economic development and foreign trade in the fall of 1978, foreign trade organizations and ministries began a rush to sign protocols and comprehensive agreements with foreigners; in 1978, contracts totalling $7.8 billion were signed with the West.

Comprehensive readjustment, led by then Vice Premier Deng Xiaoping and a group of other economic leaders who were dubbed "the pragmatists", was a result of a Standing Committee Meeting decision in December 1978 to revise China's economic program. The Chinese leadership recognized that China was overcommitted to modernization, which over 10 years would have required some $140 billion of capital investment of which $60 billion would have come from the West. Readjustment was central to the government's effort to regain control of heavy industry development, and particularly of modernization's most visible part, foreign trade. New methods of directing, implementing, and controlling modernization and foreign trade were necessary. This paper will attempt to describe decentralization as it applies to foreign trade.

C. Foreign Trade Policy

Readjustment in foreign trade was marked by the suspension in February, 1979 of nearly 60 contracts, worth $2.5 billion, for major petrochemical plants. Most of these contracts had been signed in December, 1978 and were awaiting high level governmental approval. Many of the suspended contracts were subsequently reinstated by May, 1979. The vacillation of contracting procedures pointed up two major difficulties facing the leadership, namely, lack of finances and the inefficient and cumbersome government bureaucracy.

The new era of trade decentralization and, concurrently, modernization, began in June, 1979, when the National People's Congress restated trade policy as the use of various reasonable forms of absorbing foreign funds. This rather vague policy statement was interpreted as permitting a wide variety of central government and provincial organizations to engage in foreign trade. Until this Pandora's box was opened, foreign trade had been the exclusive domain of the Ministry of Foreign Trade working through its foreign trade corporations. But after June 1979, foreign trade policy responsibility was increasingly challenged by other ministries and central government organizations. This policy debate over who should control foreign trade and the foreign exchange it generates continues unabated, and may only be resolved by leadership changes at the highest level of the government.

II. CENTRAL GOVERNMENT REORGANIZATION

A. State Commissions and Ministries

Modernization sparked the reorganization of the central government. One of the first stages of reorganization was to reconstitute or establish a number of State Commissions. Before 1978, the Chinese had only four State Commissions for industry. Since then, eight State Commissions have been formed. Three of the eight established after the National People's Congress in June 1979 had major roles to play in economic, trade, and commercial matters, namely, the Finance and Economic Commission (July), and the Foreign Investment and Control Commission and the Import-Export

Commission (August). The Foreign Investment and Control Commission (FICC) had the same staff as the Import-Export Commission. As the Import-Export Commission, it controlled access of domestic organizations to foreign exchange. Wearing its FICC hat, it reviewed and passed approval on investment by foreigners and contractual obligations made by Chinese organizations with foreigners.

Other State Commissions were established for agriculture, energy, and machine building industries. These were supra-ministry agencies that had their own planning and foreign trade authority and interests. Administratively, they were equivalent to the traditional State Commissions. The new State Commissions were formed to cope with large projects and development proposals that did not fit efficiently into the existing bureaucratic structure. For this reason considerable reorganization occurred in the Ministries they controlled.

In the last two years, implementation of national plans has been diffused through an increasingly complex and overlapping bureaucratic structure. Difficulties of administering the government were compounded by the increase of ministries from 26 in 1979 to 38 in 1980. (See Table 1.) Until late 1981, thirty ministries currently were responsible for economic matters, transport, finance, and trade.[1] The remaining eight handled non-economic and non-commercial fields. The State Council had also established or strengthened several bureaus that reported directly to it such as the General Administration of Foreign Exchange Control and the China International Trust and Investment Commission (CITIC).

TABLE 1.—INCREASE IN NUMBER OF NATIONAL TRADE-RELATED ORGANIZATIONS OF THE PRC

	1978	1979–80
Central ministries	26	38
Central commercial and foreign trade corporations	[1] 15	153

[1] Includes 9 Foreign Trade Corporations, and 6 trade facilitation organizations.

Beginning in February 1980, the ministries began to form their own foreign trade organizations. They set up industrial and import-export corporations whose functions overlapped those of similar foreign trade corporations of the Ministry of Foreign Trade. The new ministerial corporations now deal directly with foreigners for specialized technologies, equipment, services and exports, and especially foreign exchange. These new corporations attracted foreign investment and served as marketing organizations for their ministerial parents. They were especially useful in linking directly Chinese and foreign counterparts.

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[1] In early 1982 this organization changed dramatically as several ministries and State Commissions were merged to form a new supra-ministry to handle all aspects of foreign trade and investment. The new Ministry of Foreign Economic Relations and Trade was formed with the express purpose of consolidating all aspects of foreign trade and investment that had been previously handled by the Ministry of Foreign Trade, the Import-Export Commission and the Ministry of Economic Relations with Foreign Countries. This new supra-ministry will be headed by Vice Premier Chen Muhua. The Financial and Economic Commission ceased to exist after March 1980.

B. Legal Institutions

Besides the administrative changes at the national government level, a new national legal system to facilitate foreign trade is being established. The growth of this legal system has coincided with the efforts to decentralize China's foreign trade bureaucracy. The codification of laws that affect international trade was clearly a response to the growth of foreign trade and the proliferation of organizations resulting from decentralization. Although there is no specific connection between the creation of laws and decentralization, both phenomena reflect an underlying receptiveness to foreign investment.

In 1978, the Chinese leadership began publicly to stress the need for comprehensive economic laws and judicial organs to regulate economic transactions and handle disputes. From the beginning, official statements linked the creation of a legal system with orderly economic development. In 1979, after more than two decades in which legal developments were negligible, initiatives were undertaken to establish economic courts and to revive legal research and training. Also in 1979, the Chinese promulgated a number of laws and regulations that constitute the beginning of a legal framework for foreign investment and trade.

The Joint Venture Law, announced in July 1979, was the first legal invitation for foreigners to invest and own, albeit for a limited time, production and profit making facilities in China. Although broad in scope and lacking adequate detailed regulations to implement joint ventures, it offered a legal structure for foreign equity participation in China's modernization. The Joint Venture Law gave foreign trade corporations the right to negotiate contracts directly with foreign companies. Although it did not attract the large number of big investors that the leadership had hoped, it did create a new and promising investment climate.

In 1980, several new laws and regulations were promulgated. Of particular interest to American businessmen were corporate and individual income tax laws, which are prerequisites for negotiating a tax treaty between the United States and China. Other legislation enacted in 1980 included regulations on the registration of joint ventures, regulation of labor management in joint ventures, provisional regulations on the operation of foreign enterprises in China, and provisional regulations on exchange control. More recently, China appears to be making progress in the area of patents and copyrights.[2]

Other developments in the legal field have accompanied the creation of a commercial code. In particular, judicial organs have been created to handle economic disputes. By the end of 1980, China had established more than 1000 economic sections of People's Courts at various levels. These courts are authorized to hear cases involving foreign trade, maritime affairs, insurance, joint ventures, and a number of other economic issues.

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[2] See "Recent Developments in China's Treatment of Industrial and Intellectual Property", Michael K. Kirk, and David L. Denny in this volume.

C. The Banking System

Another major change at the national level was the restructuring and reform of the banking system to cope with the surge of financial and foreign trade activity. The 67% increase in foreign trade, between 1978 and 1979 forced the Chinese leadership to make major changes in the banking system.[3] By 1979, new policies were necessary to determine foreign exchange rates, to articulate credit and loan policies, to state financial reforms, to guide Chinese participation in international capital markets, and to facilitate foreign trade. China has four distinct but interrelated banks. As late as 1979, the main Chinese banks were under the ministry of Finance, and most finanical decisions were made only after submission to the full bureaucratic process. It soon became evident that the banking system was a far too important component of economic progress to be organized in this fashion. In February 1979, the People's Bank of China, which is both a central bank and a commerical bank, was removed from the jurisdiction of the Ministry of Finance and placed directly under the State Council. The People's Bank of China (P.B.O.C.) has a staff of over 400,000, in 39,000 branches, sub-branches, and offices distributed around the country.

In April 1979, the second largest bank, the Bank of China, (B.O.C.) was also upgraded to the ministerial level. It is the only Chinese bank with overseas branches in Hong Kong, Singapore, London, and Luxembourg. A branch was opened in New York City on April 11, 1982. The Bank of China has a staff of approximately 5,000 in its 77 domestic branches. Previously, the B.O.C. was under the jurisdiction of the People's Bank of China, but at present it is not generally known just how much control the P.B.O.C. exercises over the B.O.C. For example, it appears that the P.B.O.C. sets the foreign exchange rates, while the B.O.C. handles the actual transactions.

China's other two banks are for domestic banking and investment. They have no direct foreign trade function. The Bank of Agriculture's (BOA) purpose is to lend to agricultural communes or to enterprises within the communes. First established in 1951, its operations were closed down at the start of the Cultural Revolution in 1979 and put directly under the State Council, but like the Bank of China, it is now supervised by the People's Bank of China. The Bank of Construction was designed to allocate funds for construction projects, and it appears to have carried out this function adequately. However, since the current emphasis is away from construction and toward the renovation of old plants and equipment, the role of this bank may diminish, and there may be cuts in its budget. At present, the Bank of Construction has a total staff of 18,000. Not only is it under the day-to-day direction of both the Ministry of Finance and the State Capital Construction Commission, but it also reports directly to the State Council.

The Chinese Investment Bank (CIB) was established on December 23, 1981 with the assistance of the World Bank and with a capital base of four billion RMB. The CIB will evaluate and fund small and medium sized projects that require foreign technology and equipment inputs. The World Bank will provide initial foreign exchange requirements but later the CIB will borrow in international money markets.[4] The government appears to be experimenting with a number of reforms that could eventually give the banks even greater power to make decisions affecting the production of various state enterprises and foreign trade. To encourage foreign trade, the authorities have established an average domestic rate of Renminbi (RMB) 2.8 to the U.S. dollar in contrast to the official exchange rate of RMB 1.7 to the U.S. dollar. This internal settlement rate allows some traders to depart from the official foreign exchange rate. This marked a substantial liberalization of previous restrictions on the possession of foreign currency by Chinese organizations. All transactions are exclusively spot settlements, and there are no forward deals. Most transactions are kept between (RMB), and the U.S. dollar, although there are a few transactions in sterling or Hong Kong dollars. The Bank of China acts solely as an intermediary in these transactions. Unlike Western banks, the B.O.C. does not operate on its own behalf. The bank simply brings buyers and sellers together and charges each party a commission of 0.25%.[5] The foreign currency is provided entirely by the sellers, who represent state-owned enterprises. Normally, foreign exchange earnings must be sold to the Bank of China, except for a small portion to be kept in the seller's account, and organizations requiring foreign exchange must buy it from the bank. However, ". . . Canton banking officials said that this does not apply in the case of the bank's newly-established exchange facility".[6] If the state has no other plans for the money, the enterprise may not only sell it, but is also allowed to do so at a favorable rate. Since this arrangement has started, it has been a seller's market.

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[3] "Foreign Economic Trends and Their Implications for the United States: China, November, 1980." Department of Commerce.

During the period of expanded trade of 1979–1980, the Bank of China developed correspondent relations with 48 U.S. Banks through its head office in Beijing. Domestically, banking services in China were decentralized, with the exception of foreign accounts. According to branch bank officials, it was expected in early 1980 that the BOC would allow the main branches to conduct their own foreign credit arrangements and negotiate loans directly. By the end of 1980, however, as the result of the problems caused by allowing too many people access to the country's limited foreign exchange resources, the Bank shifted policy back toward centralization, and strict central control of the credit mechanisms was reestablished.

The Bank of China's president, Bu Ming emphasized in a Spring 1981 speech that China seeks interest-free or low interest loans from foreign governments or international financial organizations, such as the 30-year interest-free loan proposed by the Belgian government in late 1981. Bu also indicated that China is still interested in various other kinds of financial arrangements, such as buyers' and sellers' credits and direct loans. In April 1981, the

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[4] "Beijing Review," January 4, 1982, p. 8.

[5] "The Fledging Bond Mart". China Trade Report, February, 1981; published by "Far Eastern Economic Report", Hong Kong.

[6] Ibid.

Bank was also restructured to specialize in international banking services, such as joint ventures, reinsurance, and leasing. Bank capital was increased from RMB 0.4 billion to RMB 1 billion.

III. THE DECENTRALIZATION OF CHINA'S FOREIGN TRADE

Until mid-1979, foreign trade was conducted exclusively through nine [7] foreign trade corporations, which were organized according to the various commodities, equipment, or services for which they were responsible. The Ministry of Foreign Trade supervised the work of these corporations, and ensured that their import and export activities conformed with China's overall economic plan. To establish a trading relationship with the PRC, the foreign firm simply had to submit a proposal to the foreign trade corporation which had responsibility for the commodity or equipment involved. Delays sometimes occurred if there were insufficient information on the commodity or equipment which the foreign firm wished to sell to China, thus necessitating additional correspondence or a trip to the PRC.

More often than not, the lack of qualified and experienced personnel to assess the contracts, which increased dramatically after the normalization of relations between the U.S. and the P.R.C., was also responsible for delays. The assessment of contract proposals by all interested levels of the Chinese government, including potential provincial and municipal end-users, was slow and inefficient. Because the foreign trade corporation acted as "middleman" during the contract negotiations between the Chinese end-user and the foreign company, this procedure clearly favored national interests at the expense of provincial or local entities, since it granted most of the purchasing authority to the national foreign trade corporations which were under central ministerial control. Foreign firms interested in purchasing Chinese commodities could also request an invitation from a foreign trade corporation to attend the Spring or Autumn Guangzhou (Canton) Trade Fair. However, the Guangzhou Trade Fair is primarily an export commodities exhibition where Chinese manufactured goods and food products are on sale. It has been in existence since 1957, and until recently, was the only point of contact between foreign companies and Chinese trade organizations.

The nine state-controlled foreign trade corporations, the Chinese Export Commodities Fair in Guangzhou, and existing trade-related entities were sufficient to handle China's foreign trade during the early and mid seventies. But as China's new leadership invited greater foreign participation in China's modernization efforts after 1978, a deluge of contract proposals and inquiries overwhelmed the traditionally conservative and cumbersome bureaucracy. Many technical corporations were unable to get the imports they needed, and prospective foreign investors and traders were unable to reach end-user corporations. As more foreign company representatives had the opportunity to visit China's major cities, it became clear to the Chinese leadership that it would be advantageous to grant greater autonomy to local officials, who were most familiar with the needs of a particular industry or locality.

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[7] For a discussion of China's foreign trade corporations before 1979, see "Chinese Economy Post-Mao," vol. 1, Policy and Performance, Joint Economic Committee, U.S. Congress, Nov. 9, 1978, p. 763. The number of national FTC's increased to 12 with the inclusion of:

China National Instruments Import & Export Corporation.
China National Complete Plant Export Corporation.
China National Machinery & Equipment Export Corporation.

At the local level, a different phenomenon was at work. Several issues were becoming sources of friction between national and provincial level foreign trade corporations, which contributed to a decentralization of China's foreign trade structure:

1. Some provincial branches of the national foreign trade corporations were eager to export locally manufactured products and realized that well-manufactured goods meeting foreign specifications would be more marketable. Thus quality control and product innovation became issues in their effort to gain control of local exports.
2. Certain localities began to exhibit a large degree of experience and resourcefulness in the managment of their foreign trade. The port cities of Guangzhou and Shanghai, for example, have had a long history of commercial activity, and officials in these cities displayed greater ingenuity and business acumen in negotiating contracts with foreign companies. Therefore, it was unnecessary to consult with central authorities in Beijing in the handling of all trade contracts. As trade increased after 1978, these issues became increasingly contentious and contributed to Beijing's decision to grant more autonomy to localities in the conduct of foreign trade.

A. Provincial Decentralization Policy

Decentralization of China's foreign trade structure has consisted of three elements: (1) the granting of foreign exchange allocations by the central government to certain provinces and municipalities, (2) the decision to allow local authorities to retain a certain percentage of profits earned through their export promotion program, and (3) the designation of two provinces and three municipalities as "priority areas" for development.

1. ALLOCATION OF FUNDS

In 1979, the State Council authorized the allocation of 2 billion RMB for capital construction projects under provincial or municipal jurisdiction.[8] This budgetary appropriation was divided between provinces and municipalities which had been targeted for development, and provinces which had demonstrated potential in promoting foreign trade and increasing export earnings for the locality. Presumably this appropriation will be invested in the areas of tourism and light industry, which have proven profitable in generating more foreign exchange for the province/municipality.

There has been no uniformity in the amount of RMB allocated to the provinces and municipalities. Provinces such as Guangdong, which generated U.S. $1.65 million in foreign exchange earnings (an increase of 31 percent in 1981 over 1980) not only receive a larger portion, but also are granted more latitude in deciding their economic future.[9] This is significant because most provinces and municipalities must submit figures on their investment, output, and general economic plans to Beijing for final approval before the local plans may be implemented. Guangdong's performance has given the central government confidence in the province's economic planners, and the province's accounting books are no longer scrutinized in depth. Direct allocation of funds by the Bank of China to enterprises on the province level to conduct foreign trade was one of several provincial banking reforms announced in late 1980. Another reform changed credit policy so that loans could be made at the discretion of provincial officers who had a more accurate and current understanding of the local situation.

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[8] "The China Business Review," (National Council for U.S.-China Trade: March-April 1980) p. 5.

2. RETENTION OF PROFITS

Another facet of China's decentralization has been the decision by the central government to allow certain localities to retain a percentage of their profits earned from exports. The sum retained is a percentage of the amount declared as export earnings the previous year. The municipalities of Beijing and Shanghai have been authorized to retain 40 percent and 30 percent, respectively, of the revenue earned from their foreign exports.[10] Hubei and Guangdong have also been given approval to keep 40 percent of their export earnings. Organizations below the provincial level, i.e., enterprises which have been active in promoting exports, may keep 20 percent of their earnings above targeted foreign currency revenues.

Profit retention is a key motivation for provinces to engage in foreign trade. The retention of profits by individual enterprises is another innovation introduced by the central government to stimulate production and to accompany reform of management of factories. According to a People's Daily report, by August 1981, approximately 6,000 enterprises were participating in this experiment. Although the nature and degree of the reform has varied from enterprise to enterprise, innovations have included the following: (a) the participation of workers in management decisions (b) the election, rather than appointment, of managers (c) changes in the marketing of products. But the most significant—and controversial—innovation has been the introduction of the profit motive in factory management. While enterprises are still obligated to fulfill their quota of output according to the State plan, output in excess of the national plan may now be sold to other customers or to the State. A percentage of the profits earned from these sales can now be retained by the enterprises to be managed and disbursed by its management. Factories can invest this percentage of net income in expansion, bonuses for workers, or purchases of new equipment.

Certain enterprises in Sichuan province, which has been the harbinger of the reforms in enterprise management, have gone a step further by assuming complete responsibility for both profits and losses. Implementation of the profit motive as the basis of production is a radically new concept for Chinese managers whose factories have been previously maintained and subsidized by the State, regardless of profitability or output. Financial responsibility signifies that factories which incur debts, suffer decline in output, or simply cease to deliver a margin of profit, will no longer be bailed out by the State. On the other hand, profitable enterprises will be required to pay a profits tax, but can use the remaining portion of the profit as they see fit.

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[9] Unclassified Report, U.S. Consulate General in Guangzhou, Apr. 10, 1981.

[10] Terry, Edith. "Doing Business with China's Three Great Cities," The China Business Review (March-April 1980) p. 20.

3. INTRODUCTION OF MARKETING

Reforms in enterprise management, particularly the introduction of the profit motive, have led some provinces to develop skills in marketing products, whether for domestic or foreign consumption. Good marketing skills were not needed before decentralization, since the central government established production quotas and was, in effect, the customer for enterprises and the marketing apparatus.

Efforts to develop marketing skill are illustrated by the experience of Shanghai's First Bureau of Machinery and Electrical Equipment, which, in conjunction with other leading Shanghai trade organizations, is seeking the seal of approval of the American Petroleum Institute (API) for petroleum instruments produced in Shanghai. According to the U.S. Consulate in Shanghai, the municipality has recognized that, in order to make products more competitive both in domestic and foreign markets, it must produce a higher quality product, in this case, one which meets international standards. Shanghai authorities have indicated that they may also establish a new corporation to administer the manufacturing and export of its oil equipment. To find markets for this equipment, Shanghai has established a Trade Advisory Group to identify which instruments are marketable abroad. There is a strong possibility that the responsibilities of this Trade Advisory Group will include finding markets for the manufactured goods of other Shanghai industries.

Several provinces and municipalities have established representative offices in Hong Kong to attract foreign investment and trade. As of October 1981, only those provinces which have been given priority status by the central government have been permitted to set up official trade offices in Hong Kong, although it is likely that others may follow suit in the immediate future. The establishment of representative offices in a major financial and business center like Hong Kong makes it easier for the provinces and municipalities to provide the necessary information about particular enterprises which may be interested in setting up joint ventures, joint processing or joint production arrangements with foreign companies. These offices can also provide a list of major commodities or specialities which are manufactured or produced by the province or municipality.

The introduction of marketing factors in a centrally planned economy, however, has its share of detractors. In addition to leftist Party theoreticians who are critical of using capitalist methods in Chinese enterprises, there are also those who disapprove of the undesirable side effects of the experiment: i.e. a growing budget deficit, inflation, and mismanagement in the disbursement of profits and worker's bonuses. The central government has attributed the deficit to an unprecedented number of capital construction projects initiated at the provincial or local level. The setting of prices by individual enterprises seeking to boost profits has contributed to inflation and to the creation of an erratic pricing mechanism. Furthermore, managers who have little experience in the management of profit sharing have had to make difficult choices between reinvesting the profits and apportioning this new wealth among factory workers.

Although critics and detractors may not succeed in totally abolishing the experiment, the central government, however, has begun to respond to the negative aspects of the decentralization of Chinese enterprises. Factories which have been producing at a loss have been shut down, while smaller entities have been encouraged to merge and become larger, more efficient units. Other factories will be assigned as feeder factories for major enterprises and will become component manufacturers rather than complete assembly facilities.

To control the central deficit, the central government has limited the budget of provincial and municipal governments, and has reduced the number of capital construction projects which may be initiated at the local level. All capital construction projects will henceforth have to be approved by key State Council organizations, such as the State Capital Construction Commission and the State Planning Commission. Surplus funds will be reabsorbed by the central government through the sale of bonds. Provincial and municipal authorities have been encouraged to buy approximately $3 billion of treasury bonds.

These belt-tightening measures will not spell an end to all decentralization efforts, but greater financial accountability and concern for profits by individual enterprises will have a positive effect on motivation and productivity. Although the ideological debate over the introduction of market mechanisms will continue for some time, Chinese officials recognize that decentralization and management reforms have had a beneficial impact on motivation, on morale of factory personnel, and on production.

4. DESIGNATION OF PRIORITY AREAS

In late 1979, the State Council designated Beijing, Shanghai and Tianjin municipalities and Guangdong and Fujian provinces as priority areas for engaging in foreign trade and attracting foreign investment.[11]

These provinces and municipalities were not only granted authority to handle a full range of foreign trade activities but could also represent foreign trade interests of other provinces and regions. The Tianjin Foreign Trade Corporation, for example, has the authority to negotiate contracts and to arrange the import and export of commodities for Hebei, Xinjiang, Gansu, Shanxi, Shaanxi, Qinghai, Ningxia, and Nei Mongol provinces and autonomous regions. Similarly, Shanghai's vast experience in foreign trade has enabled the municipality to establish a mutually beneficial *modus operandi* with its neighboring provinces. Zhejiang, for example, provides raw cotton for Shanghai's textile industry, while the municipality's foreign trade coporations markets shirts and finished textile apparel for the province. In fact, it has become quite common for Shanghai enterprises to enter into licensing, production and compensation agreements with factories of nearby provinces. To facilitate these transactions, provincial authorities have opened offices in Shanghai and Tianjin. According to the U.S. Consulate in Shanghai, both sides stand to gain from this cooperation:

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[11] In January 1982, the State Council expanded its definition of priority areas to include China's coastal areas, and urged these regions to expand trade and maintain economic contacts with foreign countries. According to a People's Daily report, in addition to the municipalities of Shanghai, Beijing and Tianjin, and the provinces of Guangdong and Fujian, other coastal areas including the provinces of Liaoning, Hebei, Shandong, Jiangsu, Zhejiang and Guangxi Zhuang Autonomous Region, all combined accounted for 62 percent of China's total industrial value in 1980.

> For the provinces, such relationships provide badly needed infusions of capital, equipment, technical expertise and an opportunity to tap into Shanghai's relatively well developed international and domestic markets. For Shanghai, the payoff comes in the form of increased production capacity and guaranteed supplies of raw materials.[12]

The role of the municipality as "middleman" for the handling of provincial foreign trade has not been without problems. Provincial authorities resent the commission that is often charged by the municipality for negotiating and shipping for the province. Jiangsu and Zhejiang provinces, for example, are eager to expand their own foreign trade organizations so as to avoid relying on Shanghai's trade structure to handle their foreign trade.

The opening of several ports with customs facilities along the Changjiang River (Yangtze), should enable inland provinces to export their goods directly, without going through Shanghai authorities.[13] According to Sichuan's Vice-governor Mou Haixiu, export commodities produced in Sichuan can now be shipped directly from Chongqing to Hong Kong. Until April 1, 1980, goods shipped along the Changjiang from provinces such as Hubei and Sichuan had to be transshiped in the major ports of Shanghai or Guangzhou for customs proceedings.[14] Previously, the port corporations of Shanghai and Guangzhou retained the difference between import-export price and the domestic price of goods shipped through these ports. Now the provinces from which these commodities originate can accumulate all profits earned from their exports.

The impact of the opening of these seven ports is still unknown; so far, very few international ships have actually called on the ports. Although it will take some time before the Changjiang's navigation potential is fully exploited, the opening of these seven ports to foreign trade could spur the opening of additional port facilities along the Changjiang and make the river a major international transportation network.

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[12] Unclassified Report, U.S. Consulate General Shanghai, Mar. 14, 1981.

[13] "China's Seven New International Inland Ports", China Business Review (March-April 1980), p. 13.

[14] The following have been designated international ports by the China General Customs Administration: Chongqing (Sichuan), Wuhan (Hebei), Wuhu (Anhui), Nantong and Nanjing (Jiangsu), Juijiang (Jiangxi), Chengjingli (Hunan).

5. SPECIAL ECONOMIC ZONES

The Special Economic Zones (SEZ) are experiments to attract foreign investment and to practice a variety of production arrangements. The Chinese leadership describes the zones as "certain areas of land where a more open approach is to be adopted towards administration than in other inland areas, and where we are to use various forms of economic cooperation with the industrial and commercial world, including foreign friends, overseas Chinese, and compatriots in Hong Kong and Macao." In March 1979, the State Council established five separate economic investment zones in Southern China.[15] In Guangdong Province, the State Council designated Shenzhen, Zhuhai (adjacent to Macao) and Shantou. In Fujian province, the Council selected Xinglin near Xiamen, and Lanqi near Fuzhou. Regulations for the implementation of foreign participation in the zones were approved by the Standing Committee of the National People's Congress on August 26, 1980.

The special economic zones can also be described as microcosms of China's current economic affairs and as an exemplification of the new economic planning. The prestige of individual Chinese leaders is closely identified with the zones. Several prominent figures including Premier Zhao Ziyang, Xue Muqiao, Ji Chongwei, and then Vice Premier Gu Mu have publicized the roles of the SEZs.

The SEZs have been on modeled on export zones in other parts of Asia, although the Chinese are adapting the practices of those export zones to their own circumstances. In some respects China's SEZs should be more attractive to foreign investors than other Asian export or economic zones. Land rental costs are substantially cheaper than Hong Kong, and labor and other costs are negotiable, although investors claim they are still too high. Finally, certain zones are conveniently located. At the least, they are entry ports to the potentially vast China market.

Special economic zones in Guangdong are administered by the Guangdong Provicial Administration Committee in Charge of Special Economic Zone (GPACSEZ) which in October, 1981 was headed by Party Secretary Wu Nansheng. This committee oversees infrastructure development, approves foreign proposals, coordinates banks and insurance companies, supervises public welfare work, recruits suitable workers and staff, and ensures security within the zones. GPACSEZ also has responsibility for approving a potential investor's application, and then issuing registration certificates and land use certificates. Since the zones are intended to be export zones, GPACSEZ must approve domestic sales of products made in the zones and levy import duties. The Guangdong Provincial Special Economic Zones Development Company supplements and shares the responsibilities of the adminstrators of GPACSEZ. Additional regulations for Shenzhen will reportedly go into operation in January 1982.

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[15] These SEZs have historical antecedents in the Treaty Ports system established after the Opium Wars (1840-42). In a series of agreements, the Chinese were forced to cede areas in Canton, Amoy, Shanghai Nangpo and Fuzhou to foreigners. The circumstances in the 1980s are quite different and foreign participation will be exclusively on Chinese terms.

If the immediate goal of the SEZS is to attract foreign investment and technology for modernization and to create a thriving industrial community which can serve as a model for other areas of China, the zones have not been successful. One major factor discouraging foreign investors is that the SEZ bureaucracy is still inexperienced in dealing with the more sophisticated overseas Chinese from Hong Kong and Macao. Furthermore, investment regulations are vague and inconsistent, and most of the regulations for land and labor are not yet in effect. Despite a rapidly developing legal code that will improve conditions greatly, investors are unwilling to be subjected to changes in basic contracts. For example, income tax in the SEZs has been set at 15%, although several contracts had been made at 10%. The Joint Venture Law of 1979, however, set a tax rate of 33%, a figure that may drive off potential investors. Investors are pressing for new laws and concessions to correct these deficits.

The most serious operational problem of the SEZs is labor. Skilled labor is scarce, and factory labor is recruited from neighboring farming and fishing villages. Such labor is unskilled and unaccustomed to factory work. The "Iron Rice Bowl" concept, on one side, robs workers of incentives and, on the other, prevents management from dismissing inept or unsatisfactory workers. The lack of adequately trained managers is a particular handicap. The SEZs have plans for a series of technical "colleges" and institutes to train skilled workers, but these must await additional infrastructure investment from the central government. The SEZ authorities are hoping that in the interim foreign investors will train workers.

The SEZs may not develop as completely or on the timetable the leadership has proposed, but those parts of the "experiments" and the flexible measures they find useful can be replicated elsewhere. For example, the investment regulations, management techniques, and policies that prove successful in the SEZs could then be applied to inland areas, especially those lacking either the extensive overseas connections of southern China or their business experiences.

B. The Provincial Trade Infrastructure

The decentralization of China's foreign trade has introduced major changes in the way that provinces and municipalities conduct business with foreign companies. A new organizational infrastructure has been created to maximize contracts with foreign buyers and sellers, attract foreign investment to the locality, and offer attractive joint venture and compensation trade arrangements. Although there may be some differences in the scope and number of decision making entities, most provinces and municipalities like Shanghai, Beijing and Tianjin have established the following key trade organizations to conduct international trade:

1. Import-Export Office
2. Foreign Trade Bureau
3. Foreign Trade Corporation
4. Investment and Trust Corporation

1. IMPORT-EXPORT OFFICE

This is considered the most important of the four organizations, since it is primarily concerned with developing trade policy in the province/municipality, coordinating all the major contracts of its foreign trade organization, and most imporant, serving as the key link to Beijing's all-powerful Import-Export Commission and Foreign Investment Control Commission. (See note, p. 213.) These two organizations have responsibility for supervising China's imports and exports, and for approving foreign investment in the country, respectively. The Import-Export Office of each province/municipality, though it possesses a certain degree of autonomy, must still keep in close touch with Beijing regarding policy directives and must ensure that foreign exchange allocations do not exceed the budgetary allowance accorded to that particular province or municipality in conducting its foreign trade.

The Import-Export Office also coordinates with other provincial/municipal economic planning organizations to pinpoint areas in which technology imports are favored so that import acquisitions complement economic goals and ultimately maximize the productive capacity of the province/municipality. Import-Export Offices at the provincial level are also responsible for allocating foreign exchange to the various districts and municipalities on a quarterly basis.

In early 1980, the Import-Export Offices of certain provinces and municipalities were given authority to approve projects under 3 million dollars. This measure however, was not applied uniformly to all provinces and municipalities. Guangdong, for example, approved several joint ventures and compensation trade agreements which at times exceeded the 3 million benchmark. Shanghai was initially more cautious in approving contracts, although a higher value precedent has been set as a result of a $25 million cooperative venture established between the municipality and Corning Glassworks.[16]

2. FOREIGN TRADE BUREAUS

The principal point of contact for the business person wishing to do business with a particular province or municipality is the local Foreign Trade Bureau (FTB). In provinces like Hubei, Zhejiang and Sichuan, the FTB, which is also subordinate to the Ministry of Foreign Trade, can identify potential buyers and can select industrial enterprises which may be receptive to countertrade arrangements. In Hubei province, the FTB supervises the work of the local Foreign Trade Corporations (FTC), and maintains representatives in the various districts and prefectures throughout the province.

The FTB's most important activity is to promote local exports; therefore, it maintains up-to-date lists of locally produced commodities for export as well as shipping and handling information for potential importers.

The opening of seven new inland ports along the Changjiang River has enhanced the attractiveness of direct trading with

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[16] Interview with Xu Pengfei, General Manager, Shanghai Investment & Trust Co., during visit to Department of Commerce, Oct. 1, 1981.

China's hinterland provinces. Thus, the FTB's dual role as coordinator of the branches of the national foreign trade corporations and as main promoter of local exports provides one of the most basic components of China's new foreign trade structure.

3. FOREIGN TRADE CORPORATION

In certain provinces and municipalities however, the role of the Foreign Trade Bureau has been somewhat modified by the presence of another complementary organization to coordinate the activities of the local branches of the national FTCs. The Shanghai Foreign Trade Corporation (SFTC) for example, supervises the transactions conducted by the municipality's 15 foreign trade corporations and the three special departments, the Shanghai Advertising Corporation, Shanghai Transportation Corporation and the Shanghai Storage Corporation.

In the province of Fujian, a distinction is also made between the activities of the Fujian Foreign Trade Bureau and the Fujian Foreign Trade Corporation (FUJIANTRACO). The former's responsibility is to conduct surveys of foreign markets and to identify ways in which Fujian can develop its export potential abroad. Before the creation of FUJIANTRACO, the Fujian Foreign Trade Bureau was the umbrella organization which coordinated the activities of the local foreign trade corporations. Now, FUJIANTRACO not only has assumed this coordinating function, it also has become the premier business management organization for the province. According to a press release, FUJIANTRACO's responsibilities include ". . . taking on commission business (for the province), sales on consignment, mounting of exhibitions", and "entrusting and maintenance", presumably of equipment lent or leased to the province.[17]

4. INVESTMENT AND TRUST CORPORATION

This organization is responsible for attracting foreign investment and securing financing for joint ventures and compensation trade agreements. It also is the principal conduit for finding appropriate foreign partners for local enterprises, governmental entities, and industrial firms interested in establishing joint ventures.

Although the Investment and Trust Corporations of the municipalities and provinces provide services similar to those offered by the China International Trust and Investment Corporation (CITIC), the scope of their activities is limited strictly to local investment and nonconventional trade opportunities. Officials in these local investment organizations have stressed that there are no ties between them and CITIC. It is unclear, however, whether they periodically inform CITIC on investment opportunities in their locale.

Most provincial/municipal investment and trust corporations have stated that contracts between local enterprises and foreign firms will be negotiated in accordance with the guidelines of the Joint Venture Law and subsequent legislation. Once contracts are negotiated, initial approval is requested from the municipality or the province's import-export office, which in turn gets the final approval from Beijing's Foreign Investment Commission. Shanghai's Investment and Trust Corporation (SITCO), for example, operated unofficially for a year and a half before opening its doors for business on July 25, 1981. Its new mandate as principal overseer of Shanghai's foreign trade has been strengthened as the central government recognized Shanghai's importance as a major trade center in China. Among the SITCO's expanded responsibilities are:

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[17] Terry, Edith, "Decentralizing Foreign Trade: Fujian Province," China Business Review (September-October 1980), p. 15.

(1) Investigating and supplying information on the credit standing of clients, market evaluations, prices and technologies; giving advice on investment opportunities; supplying current information on laws, ordinances, taxation, wages, foreign exchange controls, accounting and auditing rules either enforced in China or in other countries and regions.

(2) Undertaking written translations, holding seminars, exchanging ideas of "common interest" (with foreign partners), and drafting documents.

(3) Arranging entry visas and travel permits within China, booking accommodations and attending to necessary arrangements for foreign business visitors during their stay in Shanghai.

SITCO has a registered capital of 100 million RMB (U.S. $70m) which has been acquired from the organizations represented among SITCO'S top officials: namely Shanghai's Municipal and Economic Commissions, the Shanghai branch of the Bank of China, the Foreign Trade Bureau, the Import-Export Office and other key economic and trade organizations. This capital will be used in the negotiation of joint ventures, compensation trade, co-production agreements, and any trade transaction which will help in developing Shanghai's economy. This new capital should be attractive enough to invite more foreign participation in Shanghai's industrial development. Since its unofficial opening in 1980, SITCO has helped to arrange nearly 2,000 processing, license and co-production contracts. Its new charter, which also stipulates investment of its capital abroad and the opening of SITCO branches overseas, should help in increasing the number of contracts between Shanghai corporations and foreign firms.

Some investment and trust corporations are organized to attract a specific clientele of joint venture partners. Tianjin's Investment and Trust Corporation (TITIC) and Fujian's Enterprise Investment Corporation, (Huafu) have sought investment from overseas Chinese for their local projects. In the case of TITIC, its 44 person board of directors includes several representatives from Hong Kong and overseas Chinese organizations.[18]

Fujian's Huafu Corporation is establishing a joint venture with a Hong Kong firm to construct a four-tower apartment complex in Fuzhou.[19] As one of Fujian's most aggressive trade organizations, Huafu not only provides the traditional services of securing investment for local projects and acting as "matchmaker" for foreign firms and local enterprises interested in joint ventures, but is also prepared to export labor abroad for overseas construction projects.[20]

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[18] Terry, Edith, "Doing Business With China's Three Great Cities", China Business Review (March-April 1980), p. 16.

[19] Terry, Edith, "Decentralizing Foreign Trade: Fujian Province", China Business Review (September-October 1980), p. 15.

C. Doing Business With China's Provinces and Municipalities

The foreign firm interested in doing business with Chinese municipalities or provinces will find that officials at this level are often willing to reinterpret established guidelines and will display greater flexibility in the negotiation of trade contracts with foreign partners. "Flexibility" and "favorable terms for the foreign firm" may, however, be synonymous with inexperience. In an effort to attract foreign business, some local officials have taken deliberate short-cuts and committed financial resources without first obtaining approval from higher authorities. In provinces and municipalities that lack commercial experiences or know-how, local officials may not be experienced in formulating standard trade contracts. The foreigner is advised to draft the contract himself, with all stipulations which he considers necessary, and then submit it to the Chinese organization with which he is negotiating. He should also be certain that his contract has been approved by the appropriate municipal authorities (this applies primarily to non-conventional trade and joint venture agreements). Finally, he should seek confirmation that approval has been granted by an appropriate financial authority. Despite these precautions, the decentralization of China's trade may prove advantageous to both parties.

1. "CASH AND CARRY" CONTRACTS

If a foreign firm is interested in purchasing a particular commodity, it should contact the foreign trade corporation responsible for that product. For example, the foreign buyer who is interested in importing toys produced in Shanghai, can contact Shanghai's Toys Import-Export Corporation. After an agreement is reached, a simple contract is drawn for both parties to sign. No approval is necessary from municipal or national authorities. Foreign firms should be aware that there is often a distinction between local and national commodities. The former are produced locally by provincial or municipal enterprises. The planning targets and actual production of these so-called "traditional" commodities, such as tea, silk, light industrial goods, etc., are coordinated by appropriate provincial/municipal or local authorities. The second group of "controlled" commodities, which include items such as steel, cotton, grain and petrochemicals, are supervised by national foreign trade corporations, and purchase of these commodities must be referred to Beijing for approval. Although some provincial/municipal foreign trade corporations have included these "controlled" items on their list of exports, only a limited amount may be exported by the localities.

Most officials responsible for the foreign trade of the provinces/municipalities play several different roles and assume various responsibilities in the major trade organizations. An individual who is responsible for overall planning at the Foreign Trade Corporation may concurrently hold positions of authority in the Investment and Trust Corporation and in the municipality's economic steering committee. Business people who conduct a substantial amount of trade with provincial and municipal authorities report that this phenomenon of "one individual wearing different hats" can actually be very useful, since it can accelerate the approval time for contracts. Interlocking directorates can be especially advantageous if the Chinese trade official who is negotiating a compensation trade agreement or joint-venture proposal also holds a position of authority in the provincial/municipal Import-Export Office. This dual responsibility allows the officials to specify with confidence the contribution of his organization to the commercial venture, while at the same time making it easier to obtain final approval from Beijing's Foreign Investment Commission and Import-Export Control Commission. (See footnote 1, p. 213.)

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[20] Ibid. p. 15.

2. NON-CONVENTIONAL TRADE AND JOINT VENTURES

Foreign companies interested in establishing barter, compensation trade, or joint processing/production arrangements should contact the localities' Investment and Trust Corporation or the municipal economic planning commission. In negotiating a joint venture with a factory under the jurisdiction of Beijing municipality, for example, the foreign firm can turn to the Beijing Economic Development Corporation (BEDC), the organization responsible for handling major projects, including turnkey plant and equipment contracts and loans. The BEDC will review the contract, make appropriate recommendations, and submit it to the Beijing municipality for approval. If the contract exceeds $3 billion, the municipality will need to obtain a final ruling from the national FIC and/or IECC. As stated earlier, SITCO is the principal avenue open for foreign firms to negotiate non-conventional trade agreements with the Shanghai municipality. Although individual Shanghai enterprises may conduct preliminary discussions with would-be foreign partners, negotiating authority and ultimate approval of the venture must receive SITCO's blessing.

IV. THE FUTURE OF DECENTRALIZATION

A. Policy Goals

It is clear that China's leaders are still committed to the decentralization of foreign trade. Recent pronouncements by high-level Chinese officials have allayed fears that the decentralization network established since 1979 would be hastily dismantled. Provincial economic planners will, however, need to display greater awareness of the course charted for the national economy, while continuing to attract foreign investment and contracts with foreign partners. One Guangdong economic official explained the effects of economic retrenchment on provincial trade:

> The economic readjustment means we are not going to get much money for investment from Center (Peking), and we will have to turn back more of our profits than we planned . . . we will still go ahead whenever we can, introducing more flexibility in our trade relations and economic planning, . . . smaller

deals such as processing contracts and compensation trade look very promising.[21]

Foreign trade officials in provincial and municipal offices disagree with the gloomy picture painted by the foreign press. While it is true that the negotiations for larger projects may be cancelled or postponed, there may be greater opportunities for firms whose interests coincide with those of the localities. China's foreign trade apparatus is still in a transitional phase while China's leaders search for a balance between central planning and market forces in guiding the economy. Shen Jueren of the Policy Research Department of the then Ministry of Foreign Trade describes the situation the following way:

> Under the planning and guidance of the State, we will allow market adjustments to operate and will use economic methods and rules to control the economy.
>
> In the same way, we will be reforming the trade system so as to satisfy the new demands of our developing foreign trade. In principle, the same direction of reform as that of the economic system will apply. Right now, we may be said to be in the idea, experimentation, and groping stage of our reforms of foreign trade. Whether or not these experiments are successful will have to be verified through actual practice.[22]

Shen's message is clear: until a new system can be established, the central government will continue to experiment with granting more decision-making powers to localities. As to the type of system that will eventually emerge, several Chinese officials have given their interpretaton of the "ideal system". During his visit to the United States in September 1980, for example, then Vice Premier Bo Yibo outlined his views of the foreign trade structure which China's current leaders hope to establish. Acccording to Vice Premier Bo, China intends to continue giving more decision-making powers to localities and enterprises. He explained:

> When we talk about the right of self-management of enterprises, we mean the right to manage their own production plan and also the marketing of their product. So this readjustment should in fact be lessening the management capacity of the central government . . . this will give full play to the strong points . . . of an enterprise, protect competition, and promote cooperation between enterprises.[23]

Although the proposed plan will involve changes in organization at the central level, the Vice Premier emphasized that trade activities "will still be carried out under the direction of the state plan".[24] Reorganization at the national level will involve, among other things, strengthening the ministries. Functional and technical ministries, such as the ministries of coal, petroleum, electronics, and some machine building, for example, may be gradually transformed into large corporations.

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[21] Parks, Michael. "Joint Ventures Fuel Boom, Create Thousands of China Jobs", Los Angeles Times, Apr. 6, 1981, p. 6.

[22] Shen, Jueren, "A Technocrat's View of China's Foreign Trade", China Newsletter, Tokyo: Japan External Trade Organization, March-April 1981, No. 31, p. 8.

[23] "Vice-Premier Bo Yibo on China's Current Priorities", The China Business Review, (November-December 1980), pp. 9–11.

[24] Ibid.

Other economic planners, such as Vice Premier Yao Yilin, contemplate an economic system in which there is a balance between "horizontal integration"—or the interaction among various enterprises and other economic actors—and "vertical integration"—or the relationship between these actors and organizations which have some measure of control over them. In an August 26 article published in People's Daily, Liao Jili, an official of the State Planning Commission, expounded on Vice Premier Yao Yilin's economic plan as delivered to the August 30 NPC Plenary Session of 1980.[25]

If Liao Jili's and Bo Yibo's comments about the direction of China's economy accurately reflect the current leadership's thinking on the degree of autonomy which should be granted to local governing bodies and enterprises, it is safe to assume that decentralization will stay on the agenda of China's economic planners. However, one major caveat which must be added to this discussion of China's foreign trade apparatus is that as of August 1982 most of the changes are still in the preliminary phase. Although China's economic structure is headed in the direction which Liao and Bo envisioned, those orchestrating the conversion are still not sure how far to go. The extent—and longevity—of the changes will have to be verified, as Shen Juren suggested, "through actual practice." [26]

B. The Guangzhou Trade Fair: Decentralization and Recentralization in Action

The Guangzhou Commodities Fair was, for many years, China's principal conduit for trade with foreign countries. As the country opened its doors to large numbers of foreign firms, and as provinces and municipalities were given greater autonomy in the management of their foreign trade, there was concern that the Fair would decrease in importance. There was even speculation that the Fair would be eliminated altogether.

This concern has proved unfounded. Although the Fair's role in China's foreign trade picture has changed, its significance has not diminished. Rather, in early 1980 a new wing was constructed adjacent to the Exhibition Hall to display additional commodities and to provide office space for the branch foreign trade corporations of several provinces. One of the most noticeable changes in the Fall 1980 and Spring 1981 fairs has been the increase in participation of Chinese trade organizations, including the provincial and municipal branches of foreign trade corporations and the import-export corporations of various Chinese ministries. The attendance of these organizations during the 1981 Spring Fair is evidence that China's decentralization drive has not lost its momentum despite recent attempts by the central government to readjust and recentralize.

The trend toward decentralization was apparent as early as 1979, with participation for the first time by the provincial branches of the Foreign Trade Corporations. However, these representatives lacked the experience and know-how of their Beijing (central office) counterparts. The 1980 Spring and Autumn exhibitions were marked by an increase in the attendance of provincial and municipal officials eager to promote the wares of their localities. Several delegations representing the import/export corporations of individual ministries, as well as several new trading corporations, also attended. The New Era Corporation made its debut as the coordinating organization for the import and export of five ministries during the Autumn 1980 Fair. The China Precision Machinery Corporation and the China Great Wall Industry Corporation, which are under the aegis of the State Council, also sent delegates to sell a variety of products at the Fair. Thus, changes at the national level, i.e., the creation of new trading organizations and the formation of Import-Export Corporations for individual ministries, were reflected at the 1980 Guangzhou Trade Fairs.

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[25] Unclassified Report, U.S. Embassy Beijing, September 20, 1980.
[26] Shen, op cit., p. 8.

Competition between provinces and municipalities to attract foreign buyers and to maximize exports were clearly evident at the 1980 Fair. According to foreign buyers who attended both Fairs, competition was so keen that representatives of a provincial FTC branch would wait outside the booth of a rival branch to lure the prospective buyer with lower prices for the same commodity. Price competition among various provinces was initially welcomed by both Fair organizers and prospective buyers, since in the long run it would give the necessary impetus for provinces to improve the quality of their commodities and speed up delivery dates. However, the arbitrary nature in which provincial authorities set prices began to worry Ministry of Foreign Trade (see footnote 1, p. 213) officials who attended the 1980 Fall Fair. Too many entities setting prices for the same commodities, compounded by the new domestic commercial foreign exchange rate of 2.8 RMB to the dollar rather than the conventional rate of 1.7 RMB, could only result in confusion and in an inability to truly assess net profits accrued during the sale.[27]

It was during the 1981 Spring Export Commodities Fair in Guangzhou that the Ministry of Foreign Trade instituted the *sange tongyi* or "three agrees" policy to reduce the chaos which resulted from price competition among the various trading organizations. Under the new policy, the central government, through the Ministry of Foreign Trade, will coordinate both prices and quantities to be sold at the Fair. This will have the effect of eliminating one recurring problem of past Fairs; i.e. the commitment by the FTCs to sell more goods than they can actually provide. Although this policy was not strictly adhered to by *all* Fair participants—indeed, those corporations with items in great demand such as down, angora, and feathers continued to sell at higher than officially set prices—this was the first time that policy decision-making was once again "recentralized" in the hands of Ministry officials in Beijing. Similar to the recentralization steps taken at the microeconomic level, the central coordination of prices and quantities to be sold by a central authority is intended to inculcate greater accountability and more financial responsibility on the part of managers of provincial foreign trade corporations.

The *sange tongyi* policy is not designed to stymie the more beneficial effects brought on by the decentralization of foreign trade. On the contrary, the increase in participation by the foreign trade organizations of individual provinces has enlivened the Fair by providing a greater variety of goods, and a marked improvement in the quality of the commodities to be sold. Beijing' attitude is that if decentralization is to continue provincial trade officials will need to display greater management and accounting skills. Delays in delivery and an erratic pricing mechanism can, in the long run, hurt China's image as a responsible trading partner, and Ministry of Foreign Trade officials are eager to dispel any notions of mismanagement or irresponsibility.

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[27] Unclassified Report, U.S. Consulate Guangzhou, May 27, 1981.

Efforts to recentralize decision-making in the hands of the central authorities has not been limited to the establishment of the *sange tongyi* policy. Beijing has also taken steps to limit the number of participating import-export trading organizations at the Export Commodities Fair. The Spring 1981 Fair was characterized by the participation of 11 major trading delegations, with several umbrella organizations representing the interests of many inland provincial trade corporations. For example, Tianjin's foreign trade organizations represented the interests of the provinces of Gansu, Qinghai, Ningxia, Inner Mongolia, Shanxi, and Shaanxi at the Spring Guangzhou Trade Fair. This was true of other commercially-active provinces and municipalities which also lent their business expertise to their neighboring provinces. It is expected that in the future the number of trade organizations representing provincial and municipal interest will increase, as their expertise in managing their foreign trade also increases.[28]

V. CONCLUSION

Beijing's effort to decentralize foreign trade parallels its problems in planning and implementing modernization. Foreign trade is one of the pillars on which modernization rests, and foreign trade must succeed if modernization is to work. By intent, modernization since 1978 has made a special place for foreign investment and participation, extending to new economic experiments such as special economic zones. Certain industrial projects and sectors will continue to receive special attention from the central government. Certain areas of the country will also be assigned high priority for investment and development, and will be permitted to benefit from special conditions including flexible financing agreements, tax holidays, and various management practices.

Although the decentralization of foreign trade will be an important element of China's development strategy of this decade, it will create additional problems for the central government. The entry of new organizations into commercial matters will further complicate the process of doing business with China. The central authorities will continue to have problems such as access to and control of foreign exchange funds, and competition among national entities for foreign investment and controls.

The implementation of decentralization will also have to be consonant with State planning objectives for the country as a whole.

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[28] In January, 1982, the organization of the Guangzhou Export Commodities Fair was substantially altered to reflect a greater concentration on heavy industry for the Spring Fairs and on light industry for the autumn fairs. The duration of the fair has also been shortened by ten days.

This means that provinces and municipalities will have greater authority in marketing and exporting local commodities abroad, but will be subject to closer scrutiny by the central authorities in their negotiation of joint venture and compensation trade agreements. Capital construction projects, or ventures which may require large financial outlays, will be discouraged unless the local authorities can demonstrate an ability to provide adequate domestic financing and resources prior to negotiations with the foreign firm. The municipalities and provinces interested in expanding existing facilities or in inaugurating new production arrangements with foreign enterprises will thus need to show more flexibility and greater imagination in financing their projects.

With these guidelines in mind, provincial and municipal leaders will continue to seek commercial agreements, especially those that will help in the development of their light industrial sector and upgrade their existing facilities. The current readjustment confirms that, while local authorities may grant preliminary approval to a contract with a foreign partner, the central authorities will retain final jurisdiction. This need not be the case with every contract negotiation. The degree of flexibility that a province or municipality may have in its commercial transactions will also depend on the political stature and capabilities of the officials consulting with the central government. As long as the central authorities are confident in the ability of provincial officials to expand trade, promote exports, and enter into financial and contractual agreements with foreign companies, while not departing from the guidelines established by Beijing, the maneuverability of the province will be enhanced. The greatest task facing trade authorities in the various municipalities and provinces is to determine to what degree they will be able to exercise final approval of negotiations for joint ventures with foreign firms.

The most important conclusion of the decentralization of foreign trade is that China's leadership is fully committed to it as one cornerstone of modernization. The trends and limits of decentralization have been carefully set forth and regardless of its innovative and experimental aspects, Beijing is clearly confident that problems and abuses will be corrected in time.

One cannot doubt that the potential impact of decentralization on China's foreign trade and economic modernization is significant. Whether this new and innovative program will succeed is a question that can only be answered after several years of implementation.

EMERGING FUNCTIONS OF FORMAL LEGAL INSTITUTIONS IN CHINA'S MODERNIZATION

By Stanley B. Lubman*

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INTRODUCTION

In 1977 when China's leaders dedicated themselves to the four modernizations, they consciously decided to reestablish formal legal institutions as part of their ambitious plan of growth. In light of China's legal history since the Communist victory in 1949, this decision is significant. Since 1949 law had borne the heavy imprimt of politics; since the late nineteen-fifties, the Chinese leadership had shown little concern for the fate of formal legal institutions; during the Cultural Revolution, the legal system had virtually disappeared. But since 1977, despite fluctuations in economic policy the attitudes of the leadership toward law, repeatedly echoed by lower-level officials, have been noticeably positive and consistent. The efforts that have been made recently to begin to build legal institutions are quite remarkable.

This essay examines recent attempts in China to create a formal legal system, identifies the principal themes associated with those efforts, and analyzes some of the functions of the new institutions. In one sense, this is an inquiry into what has come to be considered "law" or "legal" in China today.

The pages which follow first describe the lack of a legal tradition in both historical and modern times, against which current attempts to establish a legal system must be viewed. They then consider the recent efforts to create a judicial system and revive legal education and research, while identifying problems which long-established administrative practices and institutions and current policies pose for the new institutions. One conclusion reached here is that the attempt to refashion the legal system apparently aims at raising the regularity of official behavior and increasing stability of expectations beyond levels previously known in China since 1949. At the same time, however, the future growth and autonomy of legal institutions are likely to be limited by policies, procedures, attitudes, and habits of behavior among officials and populace alike. Specifically, the announced goal of regularity in making and applying legal rules may be contradicted by the long established mobilizational style of communist administration, by the dominant role of the Communist Party, and by techniques of using the law as an instrument to enforce discipline, assist in the implementation of current policies, and deter violations of social order.

This essay then identifies some of the functions served by the new institutions, of which the most prominent appear to be (1) reinforcement of discipline and maintenance of social order, (2) control of official arbitrariness, and (3) prospective guidance of organizational and individual behavior, particularly economic. No institution serves only one function, and Chinese legal institutions already serve mutually inconsistent ones. Moreover, in the future some of their functions may change in ways unforeseen or unintended by their creators.

Lastly, some observations have been included on the role of law in China's international economic relations. New laws and regulations have been adopted recently and more are to come. The leadership appears to have the goal of establishing a framework for foreign economic activity in China, including direct investment and a variety of transactions hitherto uncommon or unknown in the

China trade. But progress towards creation of a system of clear and consistently-enforced rules to guide foreigners and Chinese officials alike is likely to be very slow.

I. Chinese Law: The First Thirty Years

Every successful revolution destroys much of the legal system of the society it has conquered. Thereafter, the government that follows, at some time however postponed, has had to create a new legal order. So too with China. But the Chinese case is possibly exceptional in that after the triumph of the Communist Party in 1949, China's leaders—led by China's most famous Leader—successfully prevented for 30-odd years the growth of a clearly identifiable body of legal rules, and the emergence of special agencies of the state created for the purpose of administering those rules. The most recent efforts to build a legal system are best understood if the previous partial creation—and partial destruction—of an earlier post-revolutionary Chinese legal system in the nineteen fifties are recalled.[1]

A. The Traditional Background

Even before looking briefly at the nineteen fifties, however, it is necessary to pause for a moment to reflect on some salient features of China's traditional society as they shaped the role of law in that society.[2] The history of legal institutions in China since 1949 suggests the existence of some strong continuities in Chinese cultural assumptions about law and the role of law, and also suggests that the current efforts at institution-building may lead to basic changes in Chinese attitudes towards law.

At the risk of oversimplification, it is useful to isolate four significant aspects of law in traditional Chinese society.

1. THE PREVALENCE OF INFORMAL SETTLEMENT OF DISPUTES AND PUNISHMENT OF MINOR OFFENSES

The traditional imperial bureaucracy descended territorially only to the level of the *xian* (county) magistrate, who in the Qing dynasty, as the lowest government official, governed perhaps two hundred and fifty thousand persons. Given the relatively large size of each magistrate's jurisdiction *de facto* civil authority was in the most part lodged in the local power groups: landlords, the village heads, the merchant guilds, the clan (which united all persons descended from common ancestors), and, of course, the family. All of these in theory served to heal many social rifts, largely by providing mechanisms for informal dispute settlement and by exerting pressure on disputants or other violators of social order to preserve social harmony.

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[1] For background on the Chinese legal system and Chinese law prior to the Cultural Revolution, see among others, Shao-chuan Leng, Justice in Communist China, New York: Oceana, 1967; Victor H. Li, *Law Without Lawyers*, Stanford: Stanford Alumni Association, 1977; Jerome Alan Cohen, The Criminal Process in the People's Republic of China; Cambridge: Harvard University Press, 1968; Victor Li, "The Evolution and Development of the Chinese Legal System", John M. H. Lindbeck, ed., China: Management of a Revolutionary Society, Seattle: University of Washington Press, 1971; Stanley B. Lubman, "Form and Function in the Chinese Criminal Process", Columbia Law Review Vol. 69, No. 4 (1969); and Stanley B. Lubman, "Mao and Mediation: Politics and Dispute Resolution in Communist China", California Law Review Vol. 55, (1967).

[2] See John K. Fairbank, The Cambridge History of China Vol. 10 Late Ch'ing 1800–1911 Part I pp. 9–24; Cambridge University Press 1978; Sybille Van Der Sprenkel, Legal Institutions in Manchu China, London: Athlone Press, 1962; Derk Bodde and Clarence Morris, Law and Imperial China, Cambridge; Harvard University Press, 1967; and Qu Tongzu, "The Qing Law: an Analysis of Continuity and Change," Social Sciences in China, 1980, No. 3, pp. 103–114; Li, Law Without Lawyers, supra note 1.

2. THE LACK OF FUNCTIONAL SEPARATION BETWEEN LAW AND BUREAUCRACY

Traditional China possessed an intricate criminal code. Records of past cases were preserved, which, although they had no binding precedental authority, provided guidance to judges. There were legal specialists among the officials, especially at the upper reaches of the administration where all serious cases were reviewed, and magistrates were assisted by legal clerks. But the administration of law at the county level—where most cases began and ended—was for the most part overseen by the local magistrates who more frequently than not lacked legal training. Law, then, never attained the status of a functionally specialized governmental activity.

3. THE SUBORDINATION OF LAW TO A DOMINANT STATE PHILOSOPHY

In traditional China law was essentially penal, functioning largely to reinforce the state philosophy of Confucianism. It is true that in most societies a major function of law is to support the dominant philosophical and ethical systems, but the extent to which it performed these functions in Chinese society made it unique in kind, rather than merely different in degree. For example, the punishments prescribed by the criminal code for murder were graduated in accordance with the difference between the murderer and the victim in the familial and social hierarchy. By the same token, if the murder had been committed in pursuit of one's familial duties—if, for instance, it was committed to avenge the murder of one's father—the convicted person could be allowed special consideration or pardon. In this system, "the hierarchic structure of roles espoused by the classical teachings of kinship, taught obedience to superiors, whether father or husband, gentry or official." [3]

4. POPULAR FEAR OF ENCOUNTERS WITH THE LEGAL SYSTEM

State philosophy, social structure, emphasis on informal dispute-settlement and the essentially penal nature of traditional laws mutually reinforced each other. One consequence was that China society lacked a concept of individual rights that could be vindicated by agencies of the state. Also, when parties resorted to the formal judicial power, this was viewed as signifying a serious breakdown in the social order. Legal procedures were not designed to give litigants comfort, but served rather to discourage them and others from utilizing the formal judicial process. In the inquisitorial system that prevailed, the magistrate was allowed to torture the parties; accused criminals could not be sentenced until they confessed; and no professional class of lawyers was allowed to act as intermediaries. Indeed, the men who assisted litigants in drawing up documents required in law-suits were known as "litigation tricksters." Fees and bribes which had to be paid to officials were high, and could even be ruinous.

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[3] Fairbank, *supra*, n. 2 at p. 24.

B. Chinese Law Since 1949

From the overthrow of the Qing dynasty in 1911 to Communist victory in 1949, post-imperial China was subjected to warlordism, continued exploitation from abroad, corruption within, war and civil war. Chinese nationalist attempts to reform the law were formalistic, limited to the cities, and marked by corruption and ineptitude. Certainly, given the social heritage described above and the disorder of the first half of the twentieth century, the Chinese people could not have had high expectations for a legal system when the Communist party achieved victory in 1949.

The organization, beliefs, and tactics of the Chinese Communist Party had their own characteristics which were hardly consistent with a meaningful formal legal system. The Chinese Communist Party did not neglect legal forms after its victory, but they provided them with little content. After a five-year period (1949–1953) of what Liu Shaoqi, then a Vice-Chairman of the PRC, later called "revolutionary storm," by the mid-1950's the Chinese leadership had created the outline of a functionally rational criminal justice system in which suspected offenders would be arrested by a Public Security Bureau (police), formally accused by a Procuracy, and convicted by a hierarchy of courts. For a brief interval a professional bar was established on an experimental basis, mainly in China's major cities. Its role was largely limited to defending persons accused of crimes, and the lawyers usually appeared on behalf of defendants who had already confessed their guilt.

During the same period, the scope of civil law shrank. Although provisional regulations on inheritance were enacted and ownership of some private property continued, land reform and the destruction of the landlords (1949–1952), collectivization of agriculture (1953–1956) and the "socialist transformation" of industry (completed by 1956) greatly reduced the potential scope of rules of civil law.

During this period directives transmitted through the Chinese Communist Party apparatus, statements by Chinese leaders reported in the media, and "campaigns" intended to popularize and implement policies were far more important than formal law-making in administering Chinese society. Although statutes and regulations on substantive criminal law and criminal procedure were promulgated, they were general and tentative, and their practical effect and implementation varied constantly with shifts in official policy.

Although on paper the judiciary was formally distinct from other state organizations and the Party, in practice it remained essentially undifferentiated from the administrative apparatus on the state. The Party with its tools of mobilization, the voluntaristic mass movements spearheaded by Party members and "activists," dominated the judiciary as well as the other state hierarchies. Much local dispute-settlement, for instance, was carried out by an extensive network of neighborhood committees of activists who staff the basic-level local organs of local government, such as in the streets of China's cities.[4]

But in 1956–1957 a number of leaders, particularly Liu Shaoqi, indicated a desire to move away from the use of campaigns in carrying out policy, favoring instead the use of a more regularized legal system. Even Mao stated in early 1957 that large-scale mass movements were basically over.

Six months later Mao reversed himself. The new emphasis on regularizing and developing the institutions of the state, including those of the still-emerging legal system, which had grown during the blossoming of the "Hundred Flowers," was condemned as "rightist", and by mid-1957 the slow and unsteady development of the legal system had completely stopped. The Ministry of Public Security and the Party reasserted their domination of the criminal process, leaving the newly created bar to wither away. The curricula of law faculties were heavily politicized. Although a criminal code had been drafted and considerable progress had been made in drafting a civil code, work on both was halted and neither was promulgated. In the early nineteen-sixties, a brief attempt was made to reconstruct the legal system, only to be overwhelmed by the Cultural Revolution, which began in 1966.

But, as the Chinese themselves emphasize, the years before the Cultural Revolution should not be regarded as lawless. Many laws and regulations were promulgated and a much more extensive body of internal directives was issued and conveyed along various channels to guide the administration of state-controlled enterprises and their relations with each other. These administrative, fiscal and economic rules were not then regarded as a portion of the formal legal system. Some economic and legal specialists had argued in 1956–1957 for the need to systematize the rules applicable to economic and commercial enterprises, to create special agencies to handle disputes among such enterprises, and even to use law-trained personnel to help administer the economy. However, such proposals for development of an economic law disappeared when the Great Leap Forward began in 1958. Although they reappeared briefly during the slow reconstruction of the Chinese economy after the Great Leap, they too were also casualties of the Cultural Revolution. They have not reappeared until very recently.

It should be stressed that whatever progress made between 1949 and 1966 toward creation of a legal system was influenced by Stalinist and post-Stalinist Russia. Not only did the formal structure bear a Soviet stamp, put there by Chinese heeding the instruction to "learn from older brother." In addition most theory about the function of law, except that which emerged from the brief Hundred Flowers period of 1956–1957 was derived from Soviet models. The view of law that emerged from this period, at the risk of oversimplication, regarded law as formalizing discipline rather than creating rights. This, then, is the original theoretical basis for the legal system that is currently emerging.

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[4] *See, e.g.*, Lubman, "Mao and Mediation: Politics and Dispute Resolution in Communist China", supra, note 1; B. Michael Frolic, Mao's People: Sixteen Portraits of Life in Revolutionary China (Harvard Univ. Press 1980), pp. 133–135; 224–241.

In this context the traditional heritage of Chinese law is relevant. In Maoist China as before, law was perceived to be a vehicle for the expression of certain values which were embodied in an official philosophy and world-view, guarded by an elite charged with governing by virtue of noble example and deep wisdom. In Maoist China as before, law was undifferentiated from other bureaucratic activities. Peer group pressure was used to augment scarce governmental resources in punishing and deterring violators of social order. The system refused to recognize rights which could be asserted by individuals and vindicated by legal institutions. Except for one brief interval lawyers were targets of ideological rectification and thought reform.

The formal legal system, to the extent it existed at all before the Cultural Revolution, was nearly swept away by that spasm; it had not taken root in the inhospitable soil offered by Chinese society. More recently, the damage done to China by the Cultural Revolution has moved some Chinese leaders—and many Chinese citizens—to believe that the regularized formulation and application of known rules should have a prominent role in the government of China. When China's present leadership, victorious after the overthrow of the Gang of Four, decided to overcome the chaos of the Cultural Revolution and restabilize Chinese society, they looked back to the institutions—and some of the speculations about them—which they had begun to create over twenty years ago before the Great Leap Forward.

In some ways, therefore, current activities belatedly continue earlier Chinese efforts to build a legal system in the nineteen-fifties. The most recent developments should not obscure the fact that China had already developed, however invisible to most outsiders, a basic stratum of legal institutions and rules. They are like buildings put to ruin, for which the architectural plans have remained. Institutions and rules are now being recreated and consolidated along lines which they were intended to follow decades ago. Aspirations for law which were briefly asserted more than twenty years ago in the Hundred Flowers and then soon rejected and abandoned not only remain relevant, but are linked in the minds of Chinese modernizers with institutions that were created once before, only to be denied real life and continuity. At the same time the current experiments do not merely aim to resurrect the institutions of the nineteen fifties, but also encourage some Chinese to look further, albeit hesitantly, to a different kind of society. How far the new institutions can go beyond their original models is still difficult to say.

The mixed legacy of values, practices and institutions which has restrained the role of law in China in the past provides a necessary perspective on recent developments in the legal sphere. Viewed from that perspective, China's leaders are not only drawing on their cultural legacy, but are seeking in some important ways to transcend it. Before analyzing it below, however, it is necessary to examine the process of institution-building.

II. INSTITUTION-BUILDING

A. Codes

From the late nineteen fifties until 1978 China's leadership did not move to enact legal codes. After a new Constitution was adopted by the First Session of the Fifth National People's Congress in early 1978 the need for law codes began to be stressed publicly for the first time in more than twenty years.[5] Some articles began to link orderly economic development with the growth of a legal system; one, for instance, warned that unless "explicit and standardized provisions" were enacted, progress toward attainment of the Four Modernizations would be hampered.[6]

Codification proceeded surprisingly quickly. Then Vice-Premier Ye Jianying stated in early 1979 that studies on drafting new laws and revising existing laws were being made for presentation of the next session of the National People's Congress.[7] In January 1979, it was announced that deliberations would begin "shortly" on the new codes.[8] In late February, Peng Zhen, former Mayor of Peking and an early target of the Cultural Revolution, was named head of a newly created Legislative Commission of the National People's Congress.[9] New regulations on arrest and detention were issued.[10] In July 1979, the Second Session of the Fifth National People's Congress adopted codes of criminal law and criminal procedure (sometimes referred to below by their official titles, "The Criminal Law" and "The Law on Criminal Procedure"), as well as new laws on local people's congresses and people's governments, an electoral law, and, most novel of all, a law on joint ventures. The law on joint ventures went into effect when it was promulgated, while the others became effective in January, 1980.[11] Much civil and economic legislation is also being drafted, including a civil code.[12]

B. The Courts

1. THE JUDICIAL HIERARCHY

Most of the recent emphasis on the legal system has been devoted to rebuilding the courts and the formal criminal process. China has three types of courts: the Supreme People's Court in Beijing, local people's courts, and special courts (military, railway transport, water transport, forestry and other unspecified types). The new Organic Law of the People's Courts repeats the Constitution in stating that all citizens must be treated equally before the law. It provides for public trial and for the right of accused persons to be defended by a lawyer or other person designated by him. Cases are to be decided by a panel of judges sitting with two "assessors" chosen from the masses. Within the courts "judicial supervision" is to be exercised by "judicial committees" (a term sometimes translated as "adjudication committees") which are to "sum up judicial experience, discuss major difficult cases and other issues regarding judicial work."

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[5] See, e.g., Han Yutong, "Smash Spiritual Shackles—Do Legal Work Well", Renmin Ribao (hereafter RMRB) March 16, 1978, p. 3. Madame Han, Deputy Director of the Legal Research Institute of the Academy of Social Sciences (the Institute had itself been dismantled during the Cultural Revolution) stated that "necessary legal organs and legal institutions must be revived and established."

[6] Ibid., and Hu Qiaomu, "Act in Accordance with Economic Laws, Speed up the Four Modernizations", Foreign Broadcast Information Service, People's Republic of China Daily Report (hereafter FBIS), October 11, 1978, E1.

[7] "Ye Jianying Discusses Revisions in Nation's Legal System", FBIS February 14, 1979, E4-E5.

[8] "Central Organizations Preparing Draft of New Laws, Regulations", FBIS February 7, 1979, E3-E4.

[9] "Former Beijing Mayor Peng Zhen Heads New Legal Commission", FBIS February 26, 1979, E1-E2 (Peng held a similar position before the Cultural Revolution).

[10] "NPC Promulgates New Regulations on Arrests, Detentions", FBIS February 26, 1979, E2-E5.

[11] The texts of these laws are found in RMRB July 6, 1979 and July 7, 1980 and translated in FBIS July 27, 1979 Supplement No. 19, FBIS July 30, 1979, Supplement No. 20.

[12] A civil procedure code was promulgated on March 8, 1982. See "Civil Procedure Law of the People's Republic of China," JPRS80570, March 22, 1982, Political, Sociological, and Military Affairs, No. 283, pp. 32-67. An economic contract law was adopted on December 13, 1981, see pp. 263-267, infra.

The hierarchy of people's courts has three levels: the "basic" level (in rural counties or in districts in major cities), the "intermediate" level (essentially in provincial districts and in districts in major cities); and the "higher" level (provincial or city-wide in major cities). Above them all is the Supreme People's Court. According to the Criminal Procedure Law only one appeal to the next higher level is technically possible [13] except in cases involving the death penalty. Reflecting great concern to punish serious crimes expeditiously, the Standing Committee of the National People's Congress temporarily reduced the jurisdiction of the Supreme People's Court by deciding that from July 10, 1981 to the end of 1983, most cases involving the death sentence could not be appealed beyond the "higher" level people's courts.[14]

Efforts are being made to staff the courts and raise the legal sophistication of the judges. Progress has been slow, as is suggested by a report of a conference on judicial work in Guizhou in October, 1980, which says in part:

> Guizhou had few judicial cadres, and they were of poor quality, and the temporary shortage of cadres had not been completely resolved. The judicial systems, particularly the systems of legal practice, defense and the people's assessors, were far from meeting the requirements of a perfect legal system. The current legal propaganda and education work could not meet the demands for the development of the situation.[15]

There are other signs that progress has been modest in applying new law and procedures in China. Jiang Hua, President of the Supreme People's Court, in discussing the task of implementing the criminal law, has said:

> People's courts everywhere have done a great deal of preparatory work in putting into practice the criminal law and the law of criminal procedure [sic]. Some have also carried out test points for public trial and acquired a bit of experience as well as making some foolish mistakes.

He went on to stress the need for adequate staffing of the courts and for education of cadres on the role of the courts.[16]

The staffing problems of the courts have been reflected in the difficulty that courts have had in handling cases within the time limits provided by the code of criminal procedure. In June, 1980, for instance, the Jilin Provincial People's Congress announced that because of the large numbers of criminal cases and "the lack of sufficient personnel to handle the work at present", it would be necessary to extend certain time limits provided by the criminal procedure code, such as that for detention of an accused pending preliminary investigations (lengthened from two to three months) and for the Procuracy and courts to make decisions after investigation, prosecutions and appeal.[17] In Shanghai, it has been announced, "in view of the large number of accumulated cases and lack of personnel at present . . . the legal time limit for investigation, prosecution, [trial at] first instance and trial on appeal at second instance will be extended appropriately.[18] As will be seen below, another response to the current needs of the court is to expand facilities for training of personnel.

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[13] See also "Organic Law for People's Courts", FBIS July 27, 1979 Supplement No. 19, pp. 20-27.

[14] "Decision on Death Sentences", FBIS June 11, 1981, K4.

[15] "Guizhou Conference on Judicial Work Held 20-26 October," FBIS November 13, 1980, QF2.

[16] Jiang Hua, "Earnestly Perform People's Court Work Well". RMRB April 9, 1980, p. 3.

2. THE FORMAL CRIMINAL PROCESS AT WORK

a. Popularization of the formal criminal process

China's newspapers, radio, and television, once devoid of reference to Chinese law, are expending much effort to convince the Chinese people of the contents of, and the need for, the new legal system. Popularization of the new criminal law has been carried out energetically since the promulgation of the new code. An article in the People's Daily of July 17, 1979, for instance, called for "correctness, lawfulness and timeliness in carrying out China's criminal law and law of criminal procedure."[19] The author called for close study of important technical distinctions made in the criminal code and code of criminal procedure such as the difference between intentional and unintentional acts, and to the careful classification of cases according to statutory definition. He urged strict adherence to the rules of criminal procedure and to careful observation by each agency involved in administration of the criminal process of the limits on its activities by law. Without specifically referring to the blurring of jurisdictional lines and the police dominance of the criminal process during the 1950's and the 1960's, the author evoked that earlier perversion of the scheme when he said:

> Their operating ranges and limits of authority [*i.e.*, of police, procuracy, and courts] must not be confused. They are not interchangeable, nor can they go beyond the limits of the law. Only thus can they act in accordance and enforce it strictly.[20]

High-level support for carrying out the new laws has been repeatedly expressed in the pages of the People's Daily, as in reports on symposia attended by high-level national and local leaders.[21] Articles and pamphlets explaining substantive legal concepts and aspects of criminal procedure are frequently published.

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[17] "Resolution on Handling Cases", FBIS, June 11, 1980, S-2.

[18] "Shanghai Judicial Decision", Joint Publications Research Service, China Report (hereafter JPRS) 76621, October 15, 1980, Political, Sociological and Military Affairs, No. 128, p. 55.

[19] Wang Dexiang, "Correct, Lawful and Timely—Several Thoughts on Studying China's Criminal Law and Law of Criminal Procedure", RMRB July 17, 1980, p. 3, excerpts translated in FBIS, July 27, 1979, L1.

[20] Ibid.

[21] See, e.g., "Renmin Ribao Editorial Board Holds Symposium on New Laws", FBIS August 10, 1979, L1. "Anhui Holds Forum to Study, Publicize New Laws", FBIS August 10, 1979, 04-05.

b. Reports of criminal cases

Much publicity is regularly given to the courts in their most common activity of deciding criminal cases. In an illustrative report in early 1979, for instance, the Beijing Daily published an article describing a trial for theft in the Beijing Intermediate People's Court. The article compared adherence to the requirments of the constitution with frequent past violation of these requirements, such as openness and publicity of the trial, meaningful participation of the people's assessors, and the defendant's right to a lawyer.[22]

If the public reports of trials are intended to inform the Chinese people that people's justice has been revived, another important message is that criminal disruptions of social order must be punished severely. In an April 1979 report, for instance, nine criminal cases were discussed: two murderers were sentenced to death, an automobile thief was sentenced to death but his sectence was suspended for two years, five criminals were sentenced to various periods of imprisonment, and one criminal received a suspended sentence of three years. The trials of all of these criminals were conducted one after another by the Guangzhou Intermediate People's Court in the Guangzhou Gymnasium, and were attended by 5,000 spectators.[23]

Later in 1979, according to another report, an accused robber and murderer was tried, convicted and sentenced to death. He appealed—an unusual move—but his appeal was denied and his sentence was announced at a public meeting in a Shanghai stadium attended by more than 2,000 persons who "clapped and cheered and voiced unanimous support for the decision of the People's Court". After the verdict was read the criminal was led away and shot.[24] In another case a Shanghai worker was arrested for shielding and hiding a murderer, but because he "came to understand his criminal act" and "expressed his determination to criticize and overcome the reactionary code of brotherhood and remold himself", he went unpunished.[25] In another sensational case, an accused rapist was tried publicly and then shot. The trial was not only public but was televised.[26]

The use of sensational criminal trials to publicize the harsh punishment that awaits serious criminals has been common in China since 1949. Selective publicity of cases, especially during the proceedings before the outcome is formally known, raises the obvious questions to the foreign observer about the fairness of the trial and the distance between law and policy, which are addressed below.

c. Chinese conceptions of the public trial

At the same time, it should be noted that public trials are not held in China unless the court is convinced on the basis of its pretrial investigation that the facts alleged will be proven in open trial. Even now, if there is doubt about the defendant's guilt, the public trial will most probably not take place.

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[22] "People's Courts Said to Have Been Given Back to the Masses", Beijing Ribao January 21, 1979, JPRS Translations on People's Republic of China No. 530, June 15, 1979, pp.6-9.

[23] "Gaungzhou Intermediate People's Court Holds Public Trials", Nanfang Ribao April 10, 1979, p.1; translated in JPRS No. 530, June 15, 1979, pp. 20-21.

[24] "Shanghai District Courts Impose Death Sentences", FBIS November 19, 1979, 02-03.

[25] "Shanghai Case of Shielding Murderer Handled According to Law", FBIS August 9, 1979, 02.

[26] "Beijing Rapist-Murderer Excuted", Xinhua Daily Bulletin August 18, 1979, pp. 21-22.

Since the nineteen fifties, whenever public hearings revealed important inconsistencies in evidence gathered before and at such hearings, the courts would adjourn to continue their investigation in private. The function of the trial has been to demonstrate guilt, rather than to inquire into the alternatives of guilt or innocence. This conception of the public hearing continues to survive, as one controversial case suggests: Fu Yuehua, a leading dissident woman cadre, was convicted of violating public order by creating a disturbance to protest official inaction on her complaint that she had been raped by her supervisor. At the public hearing, she introduced two items of evidence that had not been part of the record. At that point, reported a Xinhua news release of January 6, 1980.

> "The collegiate bench of judges held that the evidence that she had put forward must be further investigated and the hearing was adjourned. The court then assigned personnel to plunge deeply into the masses and conduct a thorough investigation. Meanwhile, Fu Yuehua was called back to court several time to check the evidence.[27]

At a later public trial, Fu was convicted.[28] This and other publicly reported cases, including those attended by foreign observers, emphasize that China's judicial architects are not interested in constructing an adversary system.

In this regard, Chinese commentary on the trial of the "Gang of Four" is relevant, because it vividly illustrates basic Chinese views on the nature of the criminal trial. The trial was frequently characterized outside China as a "show trial", and as illustrating the hypocrisy of officials who have urged that China's adoption of a criminal code signals a new impartiality in Chinese law.[29] As much as the trial was a political event, it would be wrong to dismiss it as such without also trying to understand its implications for Chinese attitudes toward the criminal process.

Moreover, the Chinese leadership has been sensitive to foreign criticisms. Fei Xiaotong, China's leading sociologist and himself a previous victim of official persecution, was a member of the special tribunal that heard the case and sentenced the defendants. In an article intended to refute foreign criticism, Fei was quoted as saying, ". . . It would be improper to measure the case against the criteria of Western laws or any other foreign laws or for others to try to pick holes in China's legal proceedings." [30] Fei readily admitted that China's laws still need improvement, but he pointed to the enormity of the defendants' crimes and the extent of the injuries and deaths they are alleged to have caused. He further stated that the trial of the Gang of Four marked the conclusion of an unfortunate period in Chinese history and the beginning of a new stage of stability, unity, democracy and legal rule. Indeed, he added, it was a lesson to the Chinese people on the need for a complete legal system.

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[27] "Xinhua Gives Background, Details of Fu Yuehua Trial", FBIS January 9, 1980, L10-L14.

[28] Ibid.

[29] See e.g., David Bonavia, "Give Them Rice and Circuses", Far Eastern Economic Review, December 5, 1980, p. 12.

[30] "Jurist Fei Xiaotong Comments on Trial", FBIS February 2, 1981, L9.

Other discussions by Chinese jurists have pointed out that although China does not recognize the principle of the presumption of innocence, neither do some other legal systems; that although the judges and the tribunal took an active role in interrogating the defendants, this is common in Continental if not Anglo-American law; that the defendants were tried for acts which caused personal injuries and deaths rather than for errors of judgment in exercising their leadership of China at the time; and, most importantly, that the aim of the proceedings was to investigate the facts alleged in the accusation, and that the tribunal was throughout attentive to the need to prove the truth of the facts alleged.[31]

Limitations of space prevent detailed discussion of the case and the issues it raises. For purposes of this discussion it may suffice to say that the trial, like the political upheaval that brought about the rise of the defendants and the growth of their power, was an extraordinary event and must be judged as such. Analysis and perspective are not aided by simply characterizing it as a show trial and as unfair; on the other hand, neither is analysis aided by suspending judgment and making sweeping comparisons to the Nuremberg trials.[32]

Fei Xiaotong's comments are of interest because they express the desire to close a politicized chapter in Chinese history and advance to a system inimical to the growth of arbitrary powers like those of the defendants, and one in which legal institutions will be meaningful. More to the point, so far as China's law itself is concerned, is the insistent emphasis in most Chinese discussions of the trial of the Gang of Four on the function of the criminal trial as an investigation into the accuracy of the facts and into their sufficiency to substantiate the charges against the defendants. The trial of the Gang of Four, whatever its deficiencies from a Western perspective, illustrates a view of the criminal process which can be expected to endure and to be employed in criminal proceedings involving less infamous defendants, including foreigners.

C. Procuracy

The Procuracy is both the prosecuting authority and an agency charged with upholding the lawfulness of the prosecution. It must not only obey the law itself, but must simultaneously check any unlawfulness of the Public Security departments or the courts. Apart from its duties as a participant in the criminal process, the Procuracy has the additional affirmative responsibility of protecting the right of citizens to accuse State officials of violating the law. Further complicating its tasks, however, is the fact that the

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[31] See e.g. "Noted Jurist Evaluates Lin Biao-Jiang Qing Trial", Xinhua News Bulletin, January 29, 1981, p. 7; "Leading Jurist on Trial of Lin Biao, Jiang Qing", Xinhua News Bulletin, January 8, 1981; p. 6; "Interview with Vice-Chairman of Legal Affairs Commission", Beijing Review, January 12, 1981, Number 2, p. 21; "Noted Chinese Jurist on Principles Concerning Chinese Criminal Procedure in Trial of Lin, Jiang Qing", Xinhua News Bulletin, November 19, 1980, p. 19; "Renmin Ribao on Evidence in Lin-Jiang Trial" FBIS, February 11, 1981, L 23; "Jiang Hua on Trial of Lin Biao and Jiang Qing Cliqus", Xinhua News Bulletin, March 3, 1981, p. 14.

[32] Fox Butterfield, "In China They're Presumed Guilty Until Found Guilty", New York Times, November 23, 1980. For a scholarly analysis of the Nuremberg Trials which distinguishes them from other forms of political justice, which is relevant here, see Otto Kirchheimer, Political Justice, Princeton: Princeton University Press, 1961, pp. 323–47.

Procuracy is also supposed to heed the leadership of the Communist Party—but without, at the same time, violating its own independence under law.

The earlier Procuracy established in the nineteen fifties was unable to reconcile all of these tasks. From its inception it was dominated by the police; during the Cultural Revolution it fell into disuse and after the Cultural Revolution it was abolished. Since the adoption of the new laws in July, 1979, a regenerated Procuracy has begun to reassert its functions and try to reconcile conflicting demands made on it by law and policy.

The problems of the Procuracy have been aired publicly. For instance, at a Supreme People's Procuratorate "work forum" immediately following the National People's Congress in July, 1979, Peng Zhen, Director of the Legislative Affairs Commission of the NPC Standing Committee, sounded the basic theme in a speech in which he stressed "the need to rule the country by law and the need for the people's procuratorates at all levels to exercise procuratorial authority independently." He stated:

> It would be malfeasance if a procuratorial organ failed to do well in exercising its procuratorial authority independently. Now that the party and the state have placed this authority in your hands, you must no longer have any lingering fear but should display the spirit of one who still retains plenty of fight.[33]

Chief Procurator Huang Huoqing echoed the metaphor of struggle, calling on the Procuracy to understand they have a "arduous but glorious task". He urged them to "pluck up their spirits, unite as one and work hard." He did not minimize the obstacles they faced. He said:

> It is necessary to be fully prepared against obstructions from the practice of factionalism, the assertion of privileges and the force of old habit, to advocate the revolutionary spirit of unbending enforcement of the law, of unselfishness, and of being prepared to give our lives for the socialist legal system, to adhere to the principle of exercising our functions and authority independently according to the law and the principle that everyone is equal before the law and to strive for victories by daring to struggle and being good at waging struggle.[34]

Huang also spoke about the role of the Party. He said:

> While the law provides that procuratorial organs exercise their functions and powers independently according to the law, this does not lessen the responsibility of a party committee in leading a procuratorial organ.

Using a formulation which has apparently become standard, Huang also said that the task of the Party Committee is to exercise its leadership over questions of "line, principles and policy." The implicit but important distinction involved is between permissible general guidance and improper interference in the disposition of individual cases. Party Committees furthermore had to help the Procuracy to "overcome interference," select and train outstanding cadres, and generally assist the Procuracy in all ways possible. And, whether paradoxical or not, the Party Committee must itself supervise the Procuracy's strict enforcement of the law.[35]

Some of the aims of Procuratorial activities and problems which they raise are apparent from media reports. One article published in Shanghai stated, "procuratorial organs at all levels in this city actively uphold the legal system; working together on a task engendered by letters and inquires they redress unlawful incidents and receive the support and praise of the masses." Some units such as factories were still unlawfully arresting and imprisoning persons, confiscating personal property and restricting freedom "in the name of conducting study classes."

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[33] "Supreme People's Procuratorate Holds Work Forum", FBIS August 6, 1979, L1-L2.

[34] Ibid.

[35] Ibid.

The article further told how the leaders of a party branch in a government unit unlawfully imprisoned a worker suspected of having pilfered a watch and had held him for 26 days until he confessed. After being released, he retracted his confession and complained to the Procuracy, which investigated and brought about both an official apology to the wronged worker and return of the money he had been forced to pay as restitution. The same article also told how the Procuracy investigated the wrongful act of a Party Committee and a Public Security unit in arresting and interrogating a suspect in a rape case and obtaining his confession by torture. The units which were found to have conducted these measures unlawfully were told to apologize publicly, pay the wronged worker his wages for the period of his detention and abstain from imposing any disciplinary sanctions on him. A mass meeting was held at which "his good reputation" was restored, his wages paid in full, and thus, concluded the article, the "unlawful incident" was "redressed." It should be noted, however, that in neither of the cases described was reference made to punishment of any of the cadres involved.[36]

Media reports emphasize the role of the Procuracy as prosecutor. In mid-July, 1980 at a national conference on criminal procuratorial work, it was announced that the central tasks of the Procuracy were "to earnestly enforce the 'criminal law' and the 'law of criminal procedure,' to bring about a radical turn for the better in public order and to serve the motherland's four modernization.'"[37] Later in the year, a provincial procurator's report stated:

> Conscientiously enforcing the criminal law and the law on criminal procedure, firmly striking at criminal offenses and ensuring a political situation of stabililty and unity are important premises for the realization of the four modernizations. Since the past winter the province's public security and order have been unstable and people, one after another, called on the judicial departments to punish criminals according to the law so as to successfully maintain public security and order.[38]

When economic crimes have been of particular concern, heavy emphasis has been placed on the Procuracy's role in investigating and prosecuting persons guilty of corruption, illegal cutting down of trees, tax evasion and other economic crimes. One article complained that

> In order to protect their personal interests, some cadres of state organs whose revolutionary will has been waning do all kinds of terrible things: establishing secret ties, engaging in back door dealings and violating laws and discipline. This results in great loss to state property.[39]

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[36] Li Xia and Wang Yuanjun, "Procuratorial Organs at All Levels in This City Actively Uphold the Legal System". Shanghai Liberation Daily (Jiefang Ribao) April 2, 1979, 2, JPRS No. 530, June 15, 1979, pp. 10-12.

[37] "Huang Huoqing Addresses Conference on Prosecuting Criminals," FBIS July 7, 1980, L13-L14; see also "People's Procuratrates Legal Achievements Cited," FBIS Jan. 16, 1981, L21-L22.

[38] "Gansu Procuratorate Chief Reports at Fifth Congress FBIS January 3, 1981, T1-T2.

[39] "Better Economic Procuratorial Work Urged" JPRS No. 76674, October 22, 1980, Political, Sociological and Military Affairs No. 93, p. 1.

The article went on to complain that the Procuracy encountered considerable resistance when it tried to investigate suspected criminals; "some try to impede procuratorial organs in exercising their legal rights by pleading for mercy for defendants, making false testimony or deliberately making things difficult for procuratorial personnel." Renewed efforts were called for to assist the Procuracy to fight economic crimes.[40]

As noted below, similar reports describe the activities of the courts in punishing economic crimes. The harnessing of the institutions of the formal legal process, such as the Procuracy, to implementation of current policy raises serious questions for the future growth of Chinese law which are examined below.

D. Lawyers

1. REESTABLISHMENT OF THE CHINESE BAR

Slow progress is being made toward re-establishing the Chinese bar, which was established in the mid nineteen fifties and which has disappeared even before the Cultural Revolution. The new code of criminal procedure defines the role of lawyers in defending persons accused of crimes. They must, "on the basis of facts and law" provide material bearing on the defendant's innocence or lack of responsibility, the degree of his crime, and the gravity of punishment.[41] "Legal advisory offices" in which citizens may consult lawyers have begun to reopen.[42]

In September, 1979 the Dean of the Law Department of Beijing University was quoted as saying that the newly formed Beijing Lawyers' Association had fifteen members, "including a few trainees" and that he hoped the number would rise to 40 by the end of the year. Lawyers must be graduates of law schools or law departments. They begin as trainees and can receive a "lawyers certificate" after one year of on-the-job training. Persons who have worked as judges or Procurators in the past are qualified to be lawyers, as are law teachers. As in the Soviet Union, which supplied the model for the lawyers' associations established in the mid-1950's, clients must pay a fee for services rendered, but the fee will not be kept by the lawyers, who will be paid salaries.

The Dean noted that since April 1979, when the Beijing Lawyers' association was organized with only four members, lawyers from the group had already acted as defense counsel in over twenty cases. He told of one case in which a lawyer had successfully appealed for leniency on the ground that the defendant had committee no previous crimes, had acted only as an accessory to the burglary of which he was accused, and had also confessed and exposed the chief culprit. The Dean then said, "China is improving its legal system. I think the lawyers will contribute to the success of the work, which is vital to China's future."[43]

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[40] Ibid. See also "Procuratorates Intensify Economic Crime Inspection", FBIS, March 20, 1981, L21. (Guangdong cashier sentenced to life imprisonment for embezzling 226,000 RMB; "people's procuratorates at all levels have now directed their attention to cases involving illegal retention of profits and various types of tax evasion by some enterprises . . .")

[41] See Article 28 of "The Law of Criminal Procedure of The People's Republic of China", FBIS July 30, 1979, Supplement No. 20, p. 6.

[42] See, for example, Zeng Shuzhi, "A Legal Consultant's Office", China Reconstructs June 1980, pp. 48-49; "Yunnan Legal Advice Offices", FBIS April 25, 1980, Q2; and "Jilin County Strengthens Socialist Legal System", FBIS August 22, 1979, S2-3.

By January, 1980 the Beijing Lawyers' Association had increased its membership to 58. Expectations at that time were that it would grow to 100 by mid-1980. Offices were to be opened in several of Beijing's districts and in 12 suburban counties and districts.[44] In July 1980, the Beijing Review reported that China had nearly 200 lawyers' associations and legal advisory offices.[45]

Two years later, in January 1982, China had over 5,500 fulltime and 1,300 part-time lawyers, working in 1,300 offices.[46] By April, 1982 153 full-time and 150 part-time lawyers were working in 19 offices in Beijing.[47]

2. PERCEPTIONS OF THE ROLE OF THE LAWYER

The reestablishment of the bar means that the role of the lawyer in Chinese society must be defined. A debate common in the 1950's has been revived: When a lawyer defends persons accused of crime, is the lawyer also tainted with his client's alleged criminality? Articles in the press and legal periodicals have vigorously argued that lawyers play a constructive role by assisting the court. At the same time, public commentary has distinguished such assistance from trying to trick the courts, using technicalities, and otherwise behave the way bourgeois lawyers are supposed to. Moreover, the effectiveness of the lawyer is restrained by hostility to the presumption of innocence. Although there has been considerable discussion about this principle, it has been rejected in one publication by the Political-Legal Institute in Beijing.[48]

In August 1980, "provisional regulations" on lawyers were adopted by the Standing Committee of the National People's Congress. The lawyers are to be paid by the state, and they are not allowed to have "personal offices", according to a Xinhua press release of August 26, 1980. "No organization or person is permitted to interfere with lawyers' work", stated the release, which also said, "in performing their services, lawyers must serve the cause of socialism and the interests of the people, act on the basis of facts and take the law as their criterion."[49]

A vice-minister of justice was quoted as saying that, "many legal questions will emerge as the country reforms its economic system, and lawyers will play a large role in the settlement of economic and property disputes through mediation, arbitration and lawsuits." Unlike previous discussions of lawyers, this one emphasized the lawyer's role in civil law transactions and in foreign trade. The new lawyers' offices would of course continue to expand their activities in criminal cases as well, it seems safe to predict. Underlining the tentativeness of the Chinese in this area, as well as the newness of the institutions, is the fact that the new regulations did not go into effect until January 1, 1982.[50] In the meantime, experimentation under the new regulations was carried out to learn more about practical problems.

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[43] "Beijing Lawyers Prepare to Handle Cases", Xinhua Daily Bulletin September 6, 1980, pp. 4–6.

[44] "Beijing Lawyers' Association to Grow", Xinhua Daily Bulletin, January 30, 1980, pp. 8–9.

[45] "Legal Advisory Office," Beijing Review No. 28, July 14, 1980, p. 25.

[46] "China has 5,500 lawyers," Xinhua Daily Bulletin, January 11, 1982, p. 23.

[47] "Xinhua Discusses Role of Lawyers in Beijing," FBIS April 21, 1982, p. 1.

[48] See Wu Lei, "The Accused Has the Right to Defense", Guangming Ribao August 4, 1979, p. 3, translated in FBIS August 24, 1979, L3-L5; "Noted Jurist on Right to Defense in Chinese Law", Xinhua News Bulletin July 8, 1980, pp. 14–18; and Procedural Law Educational and Research Section of the Beijing Political-Legal Institute, Talks on the Law of Criminal Procedure of the People's Republic of China, Beijing: Qunzhong Chubanshe, 1979.

[49] "Provisional Regulations on Lawyers Adopted", Xinhua News Bulletin August 27, 1980, pp. 20–21; Text of the Regulations are found in FBIS August 28, 1980, L6–L9.

Discussion and uncertainty will undoubtedly continue as the bar expands after many years in limbo. The Provisional Regulations on Lawyers, while intending to institutionalize the bar, also express the tensions inherent in the functions of the Chinese lawyer, who must "serve the cause of socialism" and "protect the interest of the state and the collective" on the one hand, and, on the other, protect the "legitimate rights and interests of the citizens". It is worth recalling that some energetic lawyers who urged courts in the mid-nineteen fifties to find their clients innocent were later criticized for protecting criminals.

The Supreme People's Court, Supreme People's Procurate, the Ministry of Public Security, and the Ministry of Justice took further steps to implement the new regulations by issuing a joint circular describing the rights of attorneys in court proceedings, especially in criminal cases. Access to documents related to the case, except for material written by the judges, was promised. Procedures for applying to the court to visit the defendant were specified. (Lawyers were warned to be on guard that the defendant did not try to commit suicide during these consultations.) Defense lawyers must be provided with copies of all relevant materials introduced as evidence and must also provide copies of documents they introduced in defense. Other details of the rights and responsibilities of lawyers have also been specified.

It thus appears that some of the procedures needed to translate into practice general provisions designed to protect defendants' rights are beginning to be specified. Yet, problems remain. For instance, to visit a client the one or two principal defense lawyers have to obtain letters of introduction from legal advisory offices. Additional lawyers involved in the defense must get court approval. On the whole, though, while other criticisms can be made, it appears that many questions about the privileges of defense lawyers have been addressed.[51]

Doubts about the role of the lawyer will continue to exist, especially if the public trial continues to be used to demonstrate the truth of the file assembled in the case, and, therefore, the defendant's guilt. If public trials always end with guilty verdicts, they will suggest that the court will invariably find that the power of the state was properly invoked by police and Procuracy when they accused and prosecuted the defendant. The more firmly the trial supports that belief, the more limited will be the functions of the lawyer, and the more difficult it will be for the Chinese bar to defend vigorously persons accused of crimes.

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[50] "Provisional Regulations . . .", Ibid.

[51] "Unified Circular on Several Concrete Regulations for Lawyers Participating in Legal Proceedings," [issued April 27, 1981] Zhongguo Fazhibao [Chinese Legal System News], May 15, 1981 p. 1.

The role of the lawyer, therefore, contains some apparent anomalies, and may consequently continue to be muted and restrained as well. As one article has stated, "Some people feel that 'defense by lawyer is a formality, a show, and not essential.'"[52] The comments of one observer, an American law student who spent a year at Beijing University, are more hopeful. Writing in the Asian Wall Street Journal of March 29, 1980, he has said:

> In no recently reported case . . . has the defense counsel cast any doubt on his client's guilt. Arguments are confined, as they generally were even in the good old days of the 1950's, to pleas for lenient sentencing . . .
>
> The fact that China won't—and couldn't be expected to—institute a Western-style criminal defense system doesn't by any means cast doubt on the genuineness of its drive to bring lawyers into the evolving judicial process. Within limits that may well expand with further practice under the new law, the former enemies of the people will have a significant role to play if policies continue on their present course.[53]

E. Reestablishment of the Ministry of Justice

[illegible] notable recent expression of the Beijing leadership's commitment to a working legal system is the decision to reestablish the Ministry of Justice and its nationwide bureaucracy charged with coordinating the administration of justice. A Ministry of Justice had been created during the early years of the People's Republic, and headed by Shi Liang, a Japanese-educated lawyer, until 1959, when it was abolished. On September 13, 1979, at the eleventh meeting of the Standing Committee of the Fifth People's Congress, it was announced that a Ministry of Justice would be "established".

Then Vice Premier Yu Quili explained that although much of the work of the former Ministry of Justice had been conducted by the Supreme People's Court, the range of tasks were too broad for the Court to continue to carry on those functions as well as its ordinary judicial functions. The Ministry's major tasks would be:

> To exercise unified control over the various organs under the Court; manage and train judicial cadres; set up and manage higher academic institutes on political and legal affairs; institute a system of notary lawyers [sic]; popularize the legal system; compile laws and decrees; establish contacts with other ministries and do other judicial and administrative work so as to insure the enforcement of all stipulations and state laws.[54]

Several days after the announcement of this appointment Wei Wenbo, China's new Minister of Justice, was interviewed. He announced that a new university of political science and law would be established, as would an institute of forensic medicine; in addition, efforts would be made to improve the existing institutes and means for training judicial cadres. He was quoted as saying,

> With a population of 900 million, China will need millions of judicial cadres who have a high level of competence and knowledge of the law and will be effective at administering justice.[55]

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[52] "Significance of the Lawyer System Expounded", JPRS 76910 March 1, 1980, Political, Sociological and Military Affairs No. 142, p. 65.

[53] Timothy A. Gelatt, "Resurrecting China's Legal Institutions", Asian Wall Street Journal March 29, 1980, p. 4.

[54] "Late Report: Fifth NPC Standing Committee Closes", FBIS September 13, 1979, L18-L19.

[55] "New Minister of Justice Wei Wenbo Interviewed", FBIS September 17, 1979, L5-L6.

Of particular note was the suggestion that the Chinese leadership contemplates broadening the scope of professional legal activities beyond their previous extent, in looking not only to formal legal institutions such as courts but to other elements of the Chinese state system which the Chinese have not regarded as "legal". The report stated that Wei had said that:

> With the expansion of the country's socialist construction and international contacts, state organs, social bodies, enterprises and institutions would set up their own legal departments or acquire legal advisors, and so they might call for assistance from judicial departments.[56]

Since the original announcement, the work of reconstructing the Ministry has continued slowly. In June 1980, it announced the beginning of a "study class to train judicial cadres in professional judicial matters".[57] Reports in early 1980 indicated that local judicial bureaus were being created to carry out the Ministry's functions at provincial levels. Beijing now has such a bureau, as do many provinces. In April, 1981 it was announced that all 19 districts and counties under the jurisdiction of the Beijing municipal government had judicial bureaus for the first time since 1949.[58]

F. Legal Education and Research

1. LEGAL EDUCATION

China's legal education has begun to revive after disappearing entirely. Even before the Cultural Revolution the number of law schools and law departments had been reduced to less than five. All were closed, along with other institutions of higher education, during the Cultural Revolution, and were the last institutions or departments to reopen, beginning only around 1975.

At the beginning of the fall 1979 academic year a Xinhua report stated that 1,855 students majoring in law had been enrolled at the four political-legal institutes in Beijing, Shanghai, Xian and Chongqing and at the law departments of Beijing University, the People's University, Jilin University, and the Hubei Institute of Finance and Economics.

In July, 1979, according to one report, the law departments of Beijing University and of the Chinese People's University in Beijing were preparing propaganda materials to publicize the new laws and sending personnel to conduct training classes at provincial and municipal courts. The Beijing Political Science and Law College had completed a collection of lectures on criminal procedure. All three of these institutions had added new courses, including not only courses on the new laws but on such subjects as "the different schools of jurisprudence of modern capitalism".[59]

Establishment of new law departments and political-legal colleges (at which "legal workers" such as judges, prosecutors and lawyers are trained) are announced from time to time, indicating a slow but steady expansion of legal education.[60] In April, 1980 a

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[56] Ibid.

[57] "Justice Ministry Starts Training Class for Cadres", FBIS June 11, 1980, L5.

[58] "Judicial Bureau Set Up Throughout Beijing", FBIS April 20, 1981, R1.

[59] "Beijing Colleges publicize Laws Passed by NPC", FBIS July 11, 1979, R1.

[60] See, e.g., "Northwest Political Law College", FBIS August 23, 1979, T3. "Chinese Students Enroll for Law Studies", Xinhua News Bulletin September 8, 1979, pp. 18-19; (enrollment of

Continued

Xinhua release predicted that 2,000 "new students" would be enrolled in four-year courses by the fall, and added that "universities across the country are in the process of establishing law faculties . . ."[61]

Illustrating the difficulties of China's infant legal education is a report of the opening of a new political and legal cadres' school in Henan Province, which stated that

> The existing judiciary workers include few who are familiar with and understand law and possess specialized knowledge. Most of the new staff members of the front lack specialized training and knowledge. To meet the demands of the new period, it is essential to cultivate and train in a planned way large numbers of specialized people of talent who can successfully carry out the task of protecting the modernization drive.
>
> . . . This is a new school. At present its equipment and material living conditions are rather poor. We hope that everyone will display the spirit of struggling amid difficulties, work in concert, overcome the difficulties and do a good job in teaching.[62]

2. LEGAL PUBLICATIONS

Like every other type of activity related to the law, legal journals have had to have been revived in China. From 1966 until 1979 no legal publications appeared regularly in China. By mid-1981 two legal periodicals were appearing regularly, Jurisprudence Research (Faxue Yanjiu), published in Beijing, and Democracy and the Legal System (Minzhu yu Fazhi), published in Shanghai (and bearing an inscription written by Ye Jianying, who wrote "Conscientiously Strengthen Socialist Democracy and Legal System.") A third periodical containing foreign legal materials translated into Chinese has also begun to appear, International Legal Studies (Guowai Faxue), as has a new weekly called The Chinese Legal System News (Zhongguo Fazhi Bao). By early 1982, three or four additional journals were being published regularly. China has also reinstated its official Gazette, The Bulletin of the State Council of the PRC, suspended in 1966, which reappeared in the spring of 1980.

Books on law have begun to reappear, in numbers that seem extraordinarily large by comparison to those published over the last 20 years. From shelves that once displayed only Chiarman Mao's works and a limited number of political tracts, the reader can now select popular discussions of new codes and laws, treatises on a variety of subjects including jurisprudence, Chinese legal history, foreign law, and translations of foreign statutes and treatises.

3. LEGAL RESEARCH ACTIVITIES

In addition, legal research is also beginning to reappear. Forums on jurisprudence have been reported in the press, a new Chinese international law society and the Beijing Society of Law were established in 1980, and contacts with foreign lawyers and legal organizations have multiplied. Legal exchanges are being encouraged, also: Courses by U.S. lawyers at legal and foreign trade institutes have been conducted recently, and seminars had been organized at

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3,500 students expected in newly reopened Northwest Political-Legal College); "Justice Ministry Plans to Train More Lawyers", FBIS May 22, 1980, L5; "First Muncipal Night College of Law in China", Xinhua News Bulletin Dec. 13, 1980, p. 37.

[61] "China Developing Higher Education in Law", Xinhua News Bulletin April 23, 1980, p. 3.

[62] "Central Judiciary Cadre School Opens in Henan", FBIS Dec. 3, 1980, L14.

which groups of foreign lawyers have given lectures on topics of interest to a Chinese audience. At one such seminar organized by the Legal Affairs Department of the Chinese Council for the Promotion of International Trade in March-April, 1980, this author and five other lawyers, althogether from three law firms, lectured to an audience which on some days numbered over a hundred. Other seminars or series of lectures have been given by other U.S. and foreign lawyers, and will certainly continue to take place. Also, Chinese foreign trade personnel and legal workers are being sent to the United States and other countries for study at law schools and for practical experience at law firms.[63]

G. Civil and Economic Law

Although most recent institution-building has been related to criminal matters, work is proceeding in other areas as well. A code of civil procedure was adopted on March 1, 1982,[63] by which time a draft civil code was being circulated. Important no doubt to some foreigners is movement toward establishing a patent system.[64] The activity of the courts in divorce matters seems to be on the increase,[65] and reform of family law is underway.

1. MEDIATION

Of particular interest is the recent official encouragement of the use of mediation in settling disputes. To place this institution in perspective, it might be observed that since 1949 more effort has probably been devoted to institutions for informal dispute settlement than to most formal legal institutions. More recently, according to an article in the Chinese Legal System News, after a period of apparent disuse local-level mediation committees have been established, as they were during the early 1950's, on an almost nationwide basis.[66] There are presently about 680,500 such committees involving almost 4,000,000 mediators. The same article estimated that these mediation committees resolved more than 3,000,000 disputes during 1980. Depending on the specific locale, the number of disputes resolved through mediation was greater than the number of cases heard through judicial channels by a factor of between five to several ten-fold. As is customary in such discussions, they emphasize that such mediation has been generally successful and is well received by the populace.[67]

The Chinese use of mediation should be seen in its very special context. A common Chinese use of mediation has been in relatively "small" disputes, usually on the domestic or neighborhood level, involving/husband-wife conflicts or spats between neighbors.[68] Such

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[63] "Civil Procedure Law of the People's Republic of China," JPRS 80370, March 22, 1982, Political, Sociological and Military Affairs, No. 283, pp. 32-67.

[64] "Renmin Ribao Calls for Creation of Patent System", FBIS June 9, 1980, L11-L14. See also Berney, "China's Draft Patent Laws", China Business Review Mar.-June 1981, p. 39.

[65] "Beijing Officals Describe Divorce Procedures in City", FBIS, February 7, 1980, R1.

[66] Lubman, "Mao and Mediation", supra n. 1.

[67] "People's Mediation Committees Widespread in Cities and Towns," Zhongguo Fazhibao [Chinese Legal System News] January 9, 1981, p. 1; "Mediators resolve more than 54,300 Civil Dispute Cases", Xinhua News Bulletin, June 13, 1981.

[68] See generally ibid., "Twenty-seven Years Seems Like A Day: An Interview with Mediation Committee Leader Hu Ruiyi," Zhongguo Fazhibao [Chinese Legal System News] May 5, 1981, p.

Continued

disputes were settled informally long before 1949, although the People's Republic has claimed that mediation today is a uniquely Communist institution.[69] In today's China, as in the past, mediation is viewed as an alternative means of settling disputes, but a primary emphasis is also on its function as a means of suppressing disputes or preventing them from reaching the point where they must be resolved judicially.[70] The preference for avoiding third-party adjudication appears stronger than in the West.

Although mediation may reflect traditional values it has also been incorporated into the techniques used by the Communist state to penetrate Chinese society. This is illustrated by what have been described recently as the four primary "tools of the trade" of the mediator:

> (1) The mediator should actively publicize and encourage the use of mediation as a tool in dispute settlement;
>
> (2) The mediator should know the personalities, occupations, and points of tension and potential disputes of members of the community. So forearmed, the mediator, when a dispute arises, should have a fair idea of what is involved and how the dispute can be settled.
>
> (3) The mediator should pay attention to developing programs to keep children and youth occupied.
>
> (4) The mediator is expected to pay repeated visits to the families within his jurisdiction to maintain communication with them.[71]

These guides to being a good Chinese mediator underscore the desired ubiquitousness of the mediators (who are often frequently retired persons with few or no other duties) within relatively small groups, in order to promote regular and constant interaction between mediator and populace.

In their present form the mediation committees do not appear to differ substantially from the mediation committees that were created in the nineteen fifties and continued to exist during the years that preceded the Cultural Revolution. Even after the Cultural Revolution (1966-1969) although separate mediation committees may have fallen into disuse, the street "activists" continued to mediate petty disputes.[72]

It might be noted that in an earlier period the mediation committees were used to consolidate the urban apparatus of control which had been created soon after 1949,[73] and to reinforce the discipline required for industrialization which was then emphasized in economic policy. Today, perhaps, increasingly assertive mediation committees could help to strengthen the control over the lives of urban residents exercised by the local street committees, which were severely damaged during the Cultural Revolution. Striking to

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4; "Recalling People's Mediation Committee Leader Huang Hanyu," Zhongguo Fazhibao [Chinese Legal System News] January 16, 1981, p. 2; "City Dwellers and the Neighborhood Committee," Beijing Review No. 44, November 3, 1980, pp. 20-21.

[69] See e.g., Jerome A. Cohen, "Chinese Mediation on the Eve of Modernization" California Law Review, Vol. 54, p. 1201 (1966).

[70] Lubman, "Mao and Mediation," supra, note 1.

[71] "Recalling People's Mediation Committee Leader Huang Hanyu," Zhongguo Fazhibao [Chinese Legal System News] January 16, 1981, p. 2.

[72] See, e.g., Frolic, supra, n. 4 at 233-41.

[73] Lubman, "Mao and Mediation," supra, note 1.

the student of Chinese law is the similarity between Chinese media accounts of the activities of mediation committees today and those published in the nineteen fifties; now, as then, the media emphasize the desirability of using them, the contributions they make to social discipline, and their acceptance by the masses. Once again, mediation has been mustered into the service of economic discipline.

2. ECONOMIC DIVISIONS OF PEOPLE'S COURTS

Courts in a number of cities and major towns have established "economic divisions" to handle cases that may have serious economic consequences. They have been charged with responsibility to crack down on speculation, profiteering and other economic crimes, to provide efficient disposition of economic conflicts between enterprises (including Chinese and foreign enterprises), and to provide for a smooth adjustment to China's economic growth. According to a Xinhua report, by late 1980 about a thousand economic divisions had been established at various levels, most at the lowest level, and 600 more were in the process of being established.[74]

According to this same report, during 1980 the economic divisions handled a total of 6,100 cases. Of these, roughly 1,600 were cases involving economic crimes and 4,400 were cases involving economic disputes. It should be noted that more than 4,300 of the cases brought to the economic divisions were eventually resolved through mediation.[75]

Here again the preference for settling disputes by compromise rather than by use of a third party adjudicator is striking. Strong emphasis was laid on mediation by members of the Economic Division of the Beijing Intermediate-Level Court, with whom this author met in April, 1980. Similarly, Chinese factory officials have told this author and other foreigners interested in economic dispute-resolution that they would strongly prefer to reach a compromise in a dispute rather than take the matter to a court.

Clear definition has not yet been given to the jurisdiction of the new economic divisions. Recent reports have described their jurisdiction as extending to cases that involved (1) contract breach causing heavy political or economic losses, (2) serious cases of deception or shoddy work resulting in heavy losses, (3) failure to treat industrial waste or neglect or operational safety which can seriously impair the health of workers or peasants or damage public interest, (4) economic sabotage, (5) foreign trade, maritime affairs, insurance and joint ventures between Chinese and foreign corporations.[76]

It appears from this description that the authority of the economic divisions is not to be limited to matters arising out of contracts between enterprises. Rather, the economic divisions are empowered to decide any cases which may have substantial economic ramifications. For example, the economic dividion of the Chongging

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[74] "Courts Have Already Established More Than 1002 Economic Divisions," Guangming Ribao, March 27, 1981, p. 3.

[75] Ibid.

[76] E.g., "Chongqing People's Court Sets Up Economic Division," Xinhua Daily Bulletin, July 20, 1979.

Intermediate Peoples' Court heard a case involving a navigation accident on the Yangtze River. The court found that the accident was the result of a serious neglect of duty on the part of several workers, who were sentenced to prison terms. Jurisdiction of the economic division was apparently grounded on the fact that the accident involved a loss of over 300,000 yuan and resulted in fourteen deaths.[77]

Another report, from Tianjin in a Xinhua release of January 21, 1980, told how the newly established Economic Division of the Tianjin Intermediate Court had mediated a dispute arising out of the unilateral cancellation by the buyer of a contract with a commune unit for the production of circuit boards. The buyer was ordered to pay damages to compensate the seller for materials used to manufacture the eventually unwanted goods, as well as for other expenses.[78]

To foreign observers to whom special courts might be justified by reason of judicial expertise in a certain area of substantive law, the Chinese economic divisions may seem curious. The economic divisions do not seem to be premised on judicial familiarity with technical issues connected to particular types of cases. Instead, the significance of the economic divisions seems to lie in the importance of the subject matter, such as the occurrence of substantial or heavy economic loss. Explanation probably lies in recalling that since 1949 courts or tribunals have frequently been established in China on an ad hoc basis to deal with cases which are intended to the focus of special efforts, very frequently in connection with major campaigns. In earlier years, for example, special tribunals were established to deal with land reform in 1949–1951 and with cases of economic corruption during a prolonged campaign in 1953. The trial of the Lin Biao-Jiang Qing cliques was heard by special tribunals, showing that this trend continues. The present economic divisions seem to be somewhat more sedate version of these specialized tribunals, now less differentiated from the formal judicial hierarchy than their predecessors.

The difference in form seems to express an attempt to keep the new courts within the existing judicial framework rather than to establish them entirely outside it, and suggests a new willingness to respect the functional specialization of established judicial institutions. Whether the forms will also be used to develop and articulate substantive legal rules, of contractual responsibility or criminal responsibility, is too early to predict. Much will depend on whether efforts are made to define the jurisdiction and doctrine of the new courts, or whether they will be allowed to languish if the concern of the Chinese leadership to highlight economic crimes should lessen.

3. THE DEVELOPMENT OF ECONOMIC LAW

a. General

In keeping with recent emphasis on modernization of the law, much attention is being paid to the area of economic legislation. In addition to the large body of legislation already enacted, with the attempt to reform economic organizations more legislation has come into force, although much of it remains unpromulgated.[79] Alongside these developments and reflecting the wide-ranging economic reforms which are being carried out to decentralize and rationalize the organization and management of Chinese industry, the press and legal periodicals have discussed the details and underlying policies of new and proposed regulations. Recent "campaigns" regarding the need for regulation of the forestry industry, for example, have stressed the need for preservation of forests to maintain environmental balances and ensure the future of the forestry industry. According to the commentators, while the regrettable state of the industry may be due in part to an uncertain economic climate, insufficient foreign capitalization of the industry, and uncertainty of ownership rights in the forests, it is equally true that the current forestry regulations, because of lack of sufficient punitive provisions to discourage violators, is to blame for the waste of the natural resource. Thus the call to strengthen the regulations governing this area.[80] What is most significant about this discussion is that a new forestry law was adopted in principle in early 1979 at the start of the Chinese drive for legal reform.[81] The fact that the Communist Party had to issue new regulations in this area two years after the original law symbolizes many of the problems besetting China's efforts to build a modern legal system.[82]

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[77] Ibid.

[78] "Tianjin Intermediate Court Handles Economic Cases", FBIS January 23, 1980, R2-R3.

In addition to discussions of new and forthcoming economic legislation, substantial interest has been shown in the broader question of the relationship of new economic regulations to other areas of law. The most pressing question posed for Chinese lawmakers is whether the economic legislation, much of which is concerned with inter-enterprise relations, should be subsumed within the body of civil law which also applies to citizens, or should economic law be considered a separate branch? If the latter, what is the nature of its relationship to the civil law? Finally, in any case, what are the ramifications of the existence of economic legislation for the overall legal system? Students of Soviet and Eastern European societies will detect a familiar ring to these questions, which have been asked and answered in various ways by European Communist nations.

In 1979 the Law Institute of the Chinese Academy of Social Sciences sponsored a forum to consider some of these questions.[83] All of the commentators seemed to assume that economic law and civil law were two distinct, though inter-related legal spheres, and that the primary jurisprudential question they faced was determining the boundary between economic law and civil law. The discussion is worth our attention, since it is ultimately related to what has lately become a recurrent and visible issue in Chinese politics: the proper relationship betwen the individual and the state.

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[79] *See, e.g.*, alluding to many regulations enacted since 1979, "We Must Strengthen the Work of Economic Legislation," Renmin Ribao, May 14, 1981.

[80] "Run Forestry Work According to Law," Red Flag No. 5, March 1, 1981, pp. 27-31. ("Only when there is a stable policy which is trusted by the people can a stable situation for forest areas be insured.")

[81] "Text of New Forestry Act Recently Adopted by NPC," FBIS March 2, 1979 E1-10.

[82] "CCP, State Council Make Decisions on Forestry," FBIS March 12, 1981 L6-14.

[83] "Academic Forum on Civil and Economic Laws," Faxue Yanjiu, 1979 No. 4, pp. 14-22.

According to one writer, the significant difference between the two branches of law is clear:

> Economic law regulates . . . the relationships arising from the management of the national economy and the economic activities of socialist organizations. Civil law regulates . . . primarily the rights—responsibilities relationship which emerges among citizens in the course of their civil activities including the property relations between citizens and socialist *organizations*. . . . Participants of the economic law are primarily socialist *organizations* . . . the plants and enterprises under the system of ownership by the whole people and the system of collective ownership, as well as the economic organizations at all levels of the people's commune structure. On the other hand, the subjects of the civil law are primarily *citizens as individuals* vested with rights and responsibilities in the civil legal relationship. (Emphasis added.)[84]

Among the reasons for distinguishing between the civil law that applies to individuals and the economic law that applies to the state and its organs is the basic difference in the legal capacities of individual citizens and governmental agencies:

> For instance, citizens may establish between themselves relationship of loaning and borrowing currency, but this is totally different from the trust and loan relationship between the state bank and socialist economic organizations. It would be inappropriate to see the two as the same relationship of property circulation and to put them together in the same chapter of the same legal code. On the one hand the bank is an economic organization of the state; on the other hand it is also a managerial organ of the state, and has the task and powers to manage the currency on behalf of the state. To separate the coercive effect that banks have in exercising the powers of mananging the currency from the relationship of borrowing and loaning currency would cause the banks to lose their character and function in the area of trust and loans.[85]

Further, as one commentator noted, "the basic characteristic relations that are regulated by economic law are those of product allocation and commodity circulation derived on the basis of state planning." As such, economic law must assume a hierarchy in its application: ". . . The obedience that subordinates must have for superiors . . . is characteristic of the regulation of economic law.[86] On the other hand, ~~civil~~ law is premised on "The principle of equality and equitable compensation."[87] There is thus another aspect to the civil law—economic law dichotomy. Civil law relations, in short, are individualistic, unplanned and horizontal; the relationships which would fall within the ambit of economic law are collective, planned, and hierarchical.

It is thus no surprise that one commentator noted that "legal relationships under civil law are the most vividly exemplary of the principle of bourgeois rights," and that the role of civil law must be restricted in its contents and the scope of its application in a socialist society. "Under the conditions of socialism, it is inappropriate to expect that the principle of equality in the civil law relationship should be completely applicable in the commodity relations in the production sphere."[88] Relevant here are controversies arising out of emphases on both profits and noncollective enterprises, which squarely raise the ideological problems which resurgent private enterprise is bound to inspire in a socialist society.

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[84] Ibid., p. 15.
[85] Ibid., p. 18.
[86] Ibid., p. 15.
[87] Ibid., p. 18.
[88] Ibid.

It remains to be seen exactly how distinctions between the civil law and the economic law will be made in legislation. The attention being paid to it signifies a recognition that China must now address the issue of defining legal aspects of the uneasy economic relationships—and the shifting accommodations required—between the individual and the socialist state.

b. The law on economic contracts

A new Chinese law on economic contracts between enterprises within China was adopted on December 13, 1981 by the National People's Congress.[89] Although not the first attempt to legislate rules for such contracts, it is the most ambitious. It can only become meaningful, however, if very vigorous measures are taken to implement it.

The law begins by stating that it applies to "economic contracts," which are agreements between "legal persons" for achieving "a certain economic purpose and for defining [their] rights and obligations." The law's application is extended also to contracts of "individual businessmen" and "rural commune members" with enterprises, thus crossing the theoretical lines between civil and economic law as discussed above.

Basic principles are stated at the outset: Contracts must not be imposed by one party on the other, and cannot be interfered with by third parties. The contracts establish legally binding obligations on both sides, which may not unilaterally deviate from them. Contracts may be declared invalid if they violate law, policies, or plans; if they were signed through deception or coercion; if signed by an agent who oversteps his authority; or if they violate "state interest or public interests."

Other general provisions provide for powers of attorney to agents acting on behalf of economic units, and enumerate provisions which all contracts must contain as a minimum (such as object, quantity, quality, price, time limit for performance, place and mode of execution of the contract, and responsibilities for breach), use of *RMB* as the currency of payment unless otherwise stipulated by law, settlement of accounts through the bank, deposits, guarantees of performance by third parties, consequences of a finding of invalidity, calculation of product quantities and prices, standards of product quality, and a requirement of timely delivery. Rules are then stated for specific types of contracts, such as for construction projects, processing, transportation of goods, electric power supply, warehouse storage, lease of property, loans, property insurance, and scientific and technological cooperation.

An attempt has been made to set limits on changes in contracts. So long as state interests or economic plans are not adversely affected, a contract may be changed or cancelled by mutual agreement if the plan on which the contract is based is changed; if factors beyond the control of the parties make performance impossible; if a plant is closed down, ceases production or is converted to other uses; or if a party breaches the contract. However, if one party's change causes "losses" to the other, it must compensate the injured party. No contracts may be changed if they involve products provided for in the plan, unless such changes are approved by the agency that has issued the plan.

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[89] Renmin Ribao, Dec. 17, 1981. Translated in JPRS 79807, Economic Affairs, No. 194. Jan. 6, 1982, pp. 90–108.

The new law's emphasis on economic discipline is clearest in the sections on breach of contract. Responsibility for breach may be borne by one side only or shared by both. Individuals who cause "a major action or serious lawsuit" through "dereliction of duty, malfeasance or violation of the law" are subject to economic, administrative and even criminal sanctions. Even if breach is caused by the "fault" of a higher-level organization, that "leading body" may be responsible.

Damages or penalties may have to be paid (out of profits and not production costs, warns the law), although the injured party may also demand specific performance. In many cases, apparently *both* damages and a penalty must be paid: If actual loses exceed the penalty, the party at fault must also pay damages. Specific instances in which penalties and damages must be paid are then enumerated. For example, sellers of below-quality articles must pay both a penalty and damages, and suppliers of electricity must compensate consumers for losses caused by reductions in power supply brought about by the supplier's fault. Amounts of penalties and methods of calculating damages are not specified in the law.

If disputes arise out of these contracts, the two sides must "consult" with each other. If they cannot settle the dispute themselves, either party may request "mediation or arbitration," by "the organ governing contracts signed by the state," although no such organizations are specifically named in the law to handle such disputes. A knowledgeable Chinese legal scholar has stated in conversation that these are likely to be housed at various local levels of the General Administration of Industry and Commerce.

The provisions for arbitration do not mean that the courts have been neglected. A party to a contract "may also directly bring a suit . . . at the people's court." Suit in the people's courts may also be brought after aritration by way of appeal by the losing party. If a party to a contract who has breached it has been ordered to pay damages by an arbitration organ or a court, the banks must comply by effecting the payment. Criminal liability for a variety of illegal acts in connection with contracts is also stated. Finally, "foreign economic and trade contracts" are mentioned as subject to rules to be formulated separately "with reference to the principles laid down by the law and international practice."

Taken on its face alone, the new law raises many questions. It implies the development of legal rules on many issues with which the Chinese legal system has not heretofore dealt with systematically, such as interpretation of contracts, determination of fault for breach, and calculation of damages. The new law is very legalistic in requiring enterprises which entrust representatives with the power to enter into contracts on their behalf to give them powers of attorney. Contracts signed by agents who exceed their powers can be declared invalid, although the consequences of such a declaration of invalidity are not discussed.

Western legal systems abound in questions arising out of the relationships among principals, agents, and third parties. Soviet and Eastern European legal doctrine on fault for breach is extensive and growing. Chinese legal doctrine on these subjects, however, is only now in the earliest stages of evolution; a code of civil law, now under preparation, will address these subjects, but even after it is promulgated it will necessarily require much interpretation. Moreover, not many personnel at Chinese law courts or at the new arbitration organs are likely to have extensive legal training. The new rules may be too legalistic not only for the economic units whose conduct they are to regulate, but also for the officials who will administer them. At the same time, though, they may stimulate slow growth in the use of sophisticated legal concepts.

These problems are not without interest for foreigners, especially those who invest in equity joint ventures in China. Foreign trade contracts will be the subject of another law, as noted above, but when a joint venture in China concludes a contract with domestic Chinese entities, presumably it will be expected to act as a Chinese domestic entity. It is, after all, a "legal person" in China. The economic contract law can serve to link joint ventures with the rest of the Chinese economy, just as it will link Chinese units with each other. Thus, the contractual rules applicable to contracts of purchase and sale, construction projects and all the other transactions mentioned in the economic contract law should apply to such transactions when they are entered into by joint ventures. It remains to be seen, too, whether the new rule will apply in the Special Economic Zones, which are not specifically excepted from application of the law.

The new Chinese law on economic contracts responds to a web of complex problems. It reflects the perceived necessity to define and emphasize the responsibility of each economic unit for its own performance, consistent with current policy, which aims, as a recent Xinhua article put it, to "gradually make the enterprise a relatively independent economic entity." The task is not easy. For instance, media reports suggest that when enterprises plan their profits they may try to have them set at a low level so that above-plan profits, portions of which can be retained at the enterprise and distributed as bonuses, will swell. Other media reports indicate that rural production teams and brigades try to argue that natural conditions prevented them from attaining their set quotas and fulfilling their contracts.

Contracts are used to define responsibility in communist as well as capitalist legal systems. The new Chinese law on economic contract is the latest of a series in the Communist world. For many years in the Soviet Union and all other European Communist countries, contracts for products subject to economic plans have also been subject to special legal rules, and disputes arising out of them have been settled by special bodies which, except in Yugoslavia, are not part of the ordinary civil courts. In the Soviet Union, for instance, contract disputes among state enterprises are decided by arbitral boards which determine fault for breach of contract and award damages. The ordinary law courts are regarded as too cumbersome and slow-moving to adapt their decisions to implementation of the economic plans.

The Soviet system is not without problems which are likely to appear as the Chinese economy becomes more complex. The volume of cases brought to the Soviet arbitration boards has steadily risen over the years, and they have had to formalize their procedures and permit the use of lawyers, despite an earlier ideal of using simple procedures without law-trained professionals. Also, Soviet enterprise managers have been able to use the law as a shield, although the leadership may prefer to think of it as a sword to enforce discipline: Soviet enterprise managers can request an arbitration commission *release* them from obligations imposed by the economic plan before a contract has been concluded pursuant to the plan.

The new Chinese law is not the first set of rules to be enacted on contracts in China. Since 1949 rules have been established within ministries and for certain types of contracts. Many of these rules probably remain in effect. During the 1950's contract disputes were settled informally, although the Soviet contract arbitration system was studied closely and some movement toward adoption of that system was evident, at least from scholarly writings in 1956. However, the anti-rightist campaign of 1957 stopped evolution of the legal system dead and the Great Leap Forward was hardly congenial to development of economic law. Yet in 1962, during the economic revival after the Great Leap, the State Council and the Central Committee of the Chinese Communist Party issued a "notice" on the strict performance of contracts, providing for arbitration by economic commissions at various levels.[90] The system was operating in 1978, according to conversations which this author had with officials of the economic commission of one major Chinese industrial city. In the meantime, especially in recent years, internal rules on contracts have been established.

Relevant here are the recently established economic divisions of the regular peoples' courts, discussed above, the which resort can presumably be had if informal methods of dispute settlement fail. Yet, even if appropriate mechanisms for enforcing the new laws are soon established and staffed, several related problems will be encounterd by the enforcers of the new law. One is simply the tendency of officials to ignore rules which should guide their conduct. As one article in the Peoples Daily in December, 1981 said, "Even now, certain departments or units still do not understand the function of these [economic] laws and regulations. They do not know how to make use of them to guide and control economic matters." [91] The Southern Daily in an article in November 1981, was more pungent:

> In everyday life, the phenomenon of turning a deaf ear to party instructions and government decrees or failing to seriously carry them out is evident almost everywhere * * * in refusing to act upon the instructions of higher authority, some people never stop saying that they are doing so with the interest of the masses in mind * * * [92]

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[90] "Notice of the Central Committee of the Chinese Communist Party and the State Council Relating to Strict Adherence to Capital Construction Procedures and to Strict Performance of Economic Contracts," Dec. 10, 1962, in Zhonghua Renmin Gongheguo Fagui Huibian, Vol. 13 (1962-1963) [Compendium of Laws and Regulations of the People's Republic of China] Beijing: Falu Chubanshe, 1964, pp. 62-63.

[91] Gu Ming, "Further Strengthen Economic Legislative Work," Renmin Ribao Dec. 4, 1981, translated in FBIS Dec. 11, 1981, K12-K14

[92] "Nanfang Ribao on Following Party, National Rules," Nov. 28, 1981, translated in FBIS Dec. 7, 1981, P1.

Of course the new law is an attempt to bring rules to bear on economic disorder, but these complaints suggest that the old ways will die hard and that very vigorous enforcement will be needed.

Also, Chinese enterprise managers may not want to involve a court or arbitral body in settling their contact disputes. In the past, as noted above, they have preferred to compromise their problems among themselves. Preference for quiet disposition of economic differences among enterprises may be related to traditional Chinese aversions to litigation, but it probably also reflects apprehension at exposing errors or unlawful conduct to other agencies of the state.

If these observations are accurate, the goals of the new law are very ambitious. Energetic enforcement will be needed to change and guide the habits of thought of China's enterprise managers. If past Chinese practice is any guide, considerable publicity in the Chinese media will be required, in order to emphasize to Chinese managers that the drafters of the law mean business. Wide-ranging and continuing efforts over a long period of time are likely to be needed before the new law meaningfully affects the decisionmaking of Chinese enterprises.

III. PROBLEMS AND CONTRADICTIONS

The considerable efforts described above to build a legal system involve institutions incompletely constructed earlier in the history of the PRC on a Stalinist model, lacking preexisting support in the values left behind by either traditional society or the transition to revolution, and then demolished in a nationwide spasm of violence of disorder. Against the background of the previous summary it is useful to note some recurrent themes in Chinese discussions of the latest period of institution-building. These discussions help provide insight into some of the conflicting values which the legal system is perceived to embody by its architects, its participants and the populace and, therefore, into the tangled values of Chinese modernization itself.

A. Law and Mobilization

Even if a commitment has been made to develop the new legal institutions, some of the means used to invigorate them may distort their growth. Illustratively, popularization of the new legal institutions through the Party-led propaganda apparatus—a standard administrative device for the last thirty years—has been widespread. Typically, after the National People's Congress adopted a group of laws in 1979, the Anhui Provincial Party Committee called for a campaign to observe "publicizing the seven laws month" throughout the province for the 30-day period beginning from the twentieth of August.[93] Four days after the provincial forum mentioned above, the Provincial Party Committee held a telephone conference "calling on all places to further whip up an upsurge of studying and publicizing the seven laws to make them know to every household and person." [94]

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[93] "Anhui Holds Telephone Conference on Publicizing NPC Laws," FBIS, August 15, 1979, 03-4.

[94] Ibid.

Similarly, Shandong Province launched a campaign featuring special classes for members of the three agencies administering the criminal process to study the new laws, as well as propaganda materials prepared specially for the campaign (e.g. an article entitled "Communist Party Members Should Play an Exemplary Role in Enforcing and Upholding the Law"), radio broadcasts, theatrical performances, and lectures. The target of the campaign was announced: "all cadres in political and legal departments and all policemen must be trained by the end of September".[95]

To the foreign observer, use of a campaign-style approach to the regularization of legal institutions involves some inherent contradictions. Regularization does not seem to be a likely product of a campaign; it could be more logically thought to emerge, as the outcome of sustained incremental effort. So fostered, it would be more likely to endure. Campaigns also may tend to infect the legal system with precisely the kind of unevenness in the rhythms of bureaucratic and political life that law is supposed to reduce. This is even more true, obviously, of political campaigns which link legal activities to specific short-term goals, such as punishing economic crimes, and which are discussed below. Moreover, for the last thirty years the successions of campaigns and the changes in policy which they have symbolized and implemented have inspired considerable caution and cynicism among bureaucrats and populace alike.

B. Law and the Party

There are indications that the issues discussed here are clearly perceived in China, even if the vocabulary of discussion is different. The coming into force of the new codes raises some important issues. What, for instance, is to be the relationship between law and the Party? An article in the Beijing Guangming Daily on November 10, 1979, squarely asserted the supremacy of law over policy.[96] An important article in the Beijing Daily of January 4, 1980 stated that the principle of leadership by the Party did not mean "demanding that Chinese Communist Party committees at all levels be concerned about specific cases; it is mainly leadership over principles and policies . . ." Party leadership was to insure that formal legal institutions were not interfered with by "other administrative organizations, groups and individuals"—presumably even including the Party itself.[97]

Since then, the issue of the relationship between Party and courts has been discussed at some length. An article in Jurisprudential Research in early 1980 amplified and spelled out in considerable detail a view of the correct relationship, in which a separation of function had to be observed, leading to a principle of noninterference by Party Committees at courts in the decision of specific cases. Otherwise, said the authors,

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[95] Shandong Launches Campaign to Publicize New Laws", FBIS August 16, 1979, 0-3.

[96] Zhang Xin, "Enforcement of Policies and Enforcement of Laws", Guangming Ribao November 10, 1979, p. 3 in FBIS November 14, 1979, L1-L3.

[97] "Strengthen the Concept of the Legal System and Be Resolute in the Implementation of Laws", Beijing Ribao January 4, 1980.

> The judicial workers may tend to rely on the party committee to "guard the pass" and neglect their own duties . . . furthermore, the leading comrade of the party committee assisting in judicial work . . . can only have a partial understanding of the whole procedure because he does not personally attend to the case.[98]

Another article, in the Beijing Daily, complained that "some comrades, particularly leading comrades, do not comprehend the need to revoke the practice of examining and approving cases by party committees."[99] The author cited an internal instruction issued by the Central Committee of the Party and a speech by the President of the Supreme People's Court urging that party committees cease "substituting laws with personal view." Nonetheless, said the author, "the other day one responsible person of the certain county party committee interfered in a trial by wielding the baton of 'grabbing independence from the party' and unjustifiable dismissed the chief procurator from his post . . ." The seriousness of the matter and the principle of judicial independence were energetically underlined. However, other views remain entrenched. In mid-1981, an important meeting on politico-legal work concluded:

> Foreign bourgeois legal thinking should not influence and upset our judiciary. The political and legal organs are State organs of dictatorship and must remain strictly under the guidance of the Party committees at all levels.

An editorial commenting on this meeting stated if the courts were slow to punish lawbreakers severely, "the leading comrade [of the Court's Party committee] must enter, give guidance, and solve the problem."[100]

Further public emphasis on judicial independence, and additional and sustained high-level manifestations of support will no doubt continue to be necessary if judicial independence, frail in the best of circumstances anywhere, is to have any future in China. Party rule has been too long-lived and too firm to yield very easily to the courts in any significant measure.

C. Law and Discipline

With the re-establishment of the legal system has arisen the issue of the extent to which the law should reach out to punish officials for crimes, although hitherto they have usually been subject only to administrative sanctions either by the government hierarchy or by that of the Party. The Party has had its own organizations to investigate and punish breaches of discipline, which often constituted offenses against law as well. Recently, much publicity has been given to the publication of "Guiding Principles of Inner-Party Life" and to the establishment of the Party's "Central Discipline Inspection Commission."[101] The issues involved here are not merely legal, of course; they involve nothing less than the credibility of the claim of the Chinese Communist Party that it is the disciplined revolutionary vanguard of the Chinese people.

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[98] "Independent Judicial Function Party Leadership Relationship Discussed" JPRS 76527, Political, Sociological and Military Affairs No. 121, October 2, 1980, pp. 1-3.

[99] "Beijing Radio Decries Interference in Legal Cases," FBIS February 2, 1981, L8.

[100] See "Suppression of Criminality," China News Analysis, No. 121[illegible], September 11, 1981, p. 2, quoting from Renmin Ribao July 25, 1981, p. 1.

[101] See, e.g., "Deng Yingchao's Discipline Inspection Plenum Speech," FBIS March 28, 1981, L2.

1. "BUREAUCRATISM" IN GENERAL

The attention focused on Party discipline is plainly regarded by many leaders as a symptom rather than a cause of a dangerous illness that affects the Chinese body politic—"bureaucratism." [102] The term is used to describe major abuses of power by State and Party officials, including the tendency to treat one's area of jurisdiction as a private domain; feeling superior to others of lesser rank; insistence on special privileges; feeling responsibility only to superiors in rank, whose favors are pursued, often by flattery and extravagant measures; corruption, embezzlement of public funds, misappropriation of state property, accepting and giving bribes; and interceding on behalf of relatives and friends. Media accounts abound with this type of conduct, often engaged in by cadres over long periods of time and on a large scale before they were apprehended and punished.[103]

Before the Cultural Revolution, there was hardly any question that if a cadre was exposed in serious offenses against discipline, Communist morality, law, or all three, he would, in most cases, be punished, if at all, within State or Party hierarchies as an administrative matter: "demerits", warnings of various degrees of severity, demotion, transfer or dismissal have been the standard administrative punishments. In the case of Party members, suspension of Party membership or dismissal from the Party were additional serious sanctions. The problem, as one commentator in the People's Daily noted, is that because "all posts are still basically decided and appointed by higher authorities . . . some cadres, who do not have correct thinking, only hold themselves responsible to their superiors rather than to the masses, thus reversing the individual's relations with the masses and the public servant's relations with the masters." [104]

Equality of all before the law is a principle expressed in China's Constitution and Criminal Procedure Law, and much discussed in the Chinese media. Under this principle Party cadres are not above the law, and offenders—and their children, note some [105]—who

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[102] Discussion in the following paragraphs is based on "Minster Criticized for Seeking Special Privileges," JPRS 76971, December 10, 1980, Political, Sociological and Military Affairs, No. 146, p. 13; "Extravagant Eating, Drinking by Cadres Criticized", JPRS 77179, January 15, 1981, Political, Sociological and Military Affairs, No. 157, page 103; "Discipline Against Official Corruption Asserted," Ibid. at 97; "Renmin Ribao Comments on Combating Bureaucratism," FBIS May 13, 1980, L16; "Halt to Practice of Interceding on Behalf of Friends, Relatives Urged," JPRS 76971, December 10, 1980, Political, Sociological and Military Affairs No. 146, p. 38.

[103] See particularly "Discipline Against Official Corruption Asserted", Ibid.

[104] "Renmin Ribao Comments on Combating Bureaucratism", supra, note 102 at L18.

[105] Punishment of children of officials raises similar problems, and has been prominently discussed in the media. For instance, according to one report, the police in Anhui Province arrested young people for gang fighting, including several who were the children of "leading cadres of county departments and bureaus." The report stated that "some people" had asked the police, "Are you out of your mind to touch those influential people?" But the police, said the report, implemented the principle that "everyone is equal before the law" and arrested all of the offenders regardless of their parents' rank. The county Party Committee also persuaded the cadres to adopt a correct view of the matter, and one high official "demanded" that his son be sternly punished: and on the day of the boy's arrest conducted a self-criticism. "Anhui County Arrests Leading Cadres' Sons for Gang Fighting", FBIS August 8, 1979, O2-23.

More recently, in June 1980 a high ranking PLA leader was praised in the press for writing a letter to the Wuhan Public Security Bureau "demanding that the illegal activities of his great-nephew . . . be strictly dealth with." The Hubei Daily wrote an editiorial criticizing "the behavior of certain leading cadres" in trying to cover up for their lawbreaking children. "Hubei: PLA Leader Urges Punishment of Erring Relative," FBIS June 11, 1980, P1. In another incident

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violate the law must be punished according to the law and by the organs of the law.[106] From this it has been argued that merely to subject to administrative discipline officials who violate the law is insufficient punishment because, as one article puts it "'dismissal in lieu of punishment' is a reflection of the influence of a feudal privilege seeking mentality."[107] Assertion of these principles has led to judicial trial of Party members who have committed crimes.

2. PUNISHMENT OF CADRES FOR CRIMES

In one case, a commune brigade Party branch secretary was accused of stealing trees that belonged to the collective and was reprimanded, and thereafter falsely denounced the commune member who exposed his theft. The cadre was sentenced to five years in prison for misusing his authority. However, the commune Party secretary at all times tried to shield the offender wrote the Party committee later, as a result of which "the masses completely lost their confidence in the integrity of our Party organization."[108]

Another case further illustrates the problems and some current uncertainties in applying the law to cadres: in Jiangsu Province, according to a radio broadcast on July 17, 1980, the Director and Deputy Director of a local office of the Agricultural Bank of China extended loans improperly, diverted some funds for personal use, and fraudulently procured goods and materials. Their misdeeds constituted violations of administrative regulations and policies as well as the crime of embezzlement. The two men were investigated by the local party committee, the Bank, and by the local Procuracy, which arrested them, presumably so that they could be prosecuted. At the same time, it was announced that the local county "Discipline Inspection Commission" would deal with other persons involved.[109]

This report suggests both the overlapping of jurisdiction among the bodies involved and the continued prominence of the Party in dealing with offenses by Party members. The foreign observer can only ask how decisions were made to prosecute two offenders while relegating others to Party discipline. Clearly, though, such decisions were made as administrative and discretionary matters rather than as part of the formal judicial process.

A drive on economic crimes and corruption in the spring of 1982 reflected continued involvement of both Party disciplinary organizations and the courts in punishing cadres. In two cases of large-scale illegal activities, the Central Discipline Investigation Commission of the Central Committee was reported to have conducted investigations; in one case, a local Communist Party secretary in the

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that son of a "leading cadre at the municipal level" was sentenced to death for rape in Changchun, in Jilin Province. The Chinese Youth News commented "In the eighties of socialist China, no one who breaks the law can escape the arm of justice". "Youth Paper Comments on Sentences of Cadres' Children", FBIS July 2, 1980, L6–L7. In August, 1980, the Beijing Daily announced that thirty cadres' children had been sentenced for their involvement in a nationwide smuggling ring. "AFP: Press Reports Arrest of Senior Officials' Children", FBIS August 18, 1980, L3.

[106] "Radio Beijing: Party Cadres Not Above State Law," FBIS August 25, 1980, L15.

[107] "Guangming Ribao on Dismissal as Punishment", FBIS December 24, 1980, L21.

[108] "Cadres Accused of Violating Law Sentenced to Prison Terms", JPRS 76617, October 14, 1980, Political, Sociological and Military Affairs, No. 127, page 30.

[109] "Jiangsu Arrests Bank Cadres for Financial Violations", FBIS July 18, 1980, 01.

Party Committee of the Shenzhen Special Economic Zone and a local cadre, also a Party member, were relieved of their posts for smuggling foreign consumer products into China.[110] In Henan, a network of officials was punished for large-scale illegal purchases and resale of hundreds of automobiles and other vehicles, as well as extensive bribery using cash and television sets.[111] Other reports have told of arrest and conviction by the courts of an imaginative swindler who established a false institute that signed contracts with both foreign and domestic enterprises,[112] and of the head of the Guangzhou Telecommunications Bureau, for speculation and profiteering.[113] The courts were mentioned with special prominence in the last two above-mentioned cases.

3. PUNISHMENT OF CADRES FOR ADMINISTRATIVE MALFEASANCE

The widely-publicized case arising from the capsizing of an offshore oil rig, the "Bohai No. 2", which caused the deaths of 72 crew members in November 1979, is suggestive in pointing to the possibility of expansion of judicial jurisdiction over acts of malfeasance.[114] An investigation by a group representing no less than 11 national and local-level organizations concluded that the Ministry of Petroleum Industry had erroneously ordered the rig moved too quickly, that out of zeal to comply with this unreasonable order local authorities had violated safety principles, and that thereafter the Ministry failed to investigate the case properly, tried to cover it up, and failed to punish the local officials who had ordered the safety violations. The State Council removed the Minister of Petroleum Industry from his post and awarded a "demerit" to no less than Vice Premier Kang Shien: thereafter three officials of the local petroleum bureau and the captain of the towing vessel were prosecuted.

The prosecutions in the "Bohai No. 2" case as well as the cases discussed in the preceding sections suggest that the Chinese leadership may begin to expand the role of law and law courts in sanctioning officials and Party members for conduct which violates the criminal law, ranging from acts clearly contrary to their responsibilities such as theft of public funds to acts involving serious lapses of judgment in the exercise of their authority. However, in the light of Party supremacy and the weakness of formal legal institutions generally, this expanded judicial activity can only be tentative. That its implications are serious is recognized by cadres who try to interfere with citizens who accuse them and with procuracies and courts that try to bring them to justice[115] and by writers who

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[110] "Renmin Ribao Reports on Shenzhen Smuggling Case," FBIS Mar. 12, 1982, K21.

[111] "Henan Province Solves Case of Illegal Resale," FBIS Mar. 11, 1982, P9.

[112] "Swindler sentenced to 12 years", Xinhua News Bulletin, Mar. 26, 1982, p. 9.

[113] "Guangzhou Telecommunications Bureau Head Jailed", FBIS Apr. 6, 1982, W3.

[114] See "State Council Decision on Oil Rig Accident", Xinhua News Bulletin, August 25, 1980, p. 24; "Chinese Oil Minister Relieved of Post", Id. at page 25; "Ministry of Petroleum Industry Criticized for Offshore Disaster," Xinhua News Bulletin, August 24, 1980, p. 47; "Four For Trial in Oil Rig Case", Xinhua News Bulletin, August 30, 1980, p. 16.

[115] See, e.g., The Heilongjiang Daily of November 28, 1979, reporting on several cases of local Party interference in cases. In one case, a local Party secretary had "technically edited" records of an interrogation in a case involving a high-ranking Party member. In another, local officials tried to deter the Procuracy and police from prosecuting the son of fellow official for a serious traffic violation. Li Shousan and Ma Wenyuan, "Exercise Leadership, Don't Interfere—Things

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argue that there is no such thing in China as a "bureaucratic class", and that cadres guilty of bureaucratism must not be treated as enemies.[116]

It is difficult to foresee the courts becoming meaningful participants in the punishment of unlawful acts by officials and Party members in the near future, unless they are given extremely strong support at the highest levels of Chinese leadership. To do so, however, could easily lead to charges of destroying the Party by rendering it hostage to accusations by antisocialistic non-Party enemies who could pervert the law to weaken Party rule, and, therefore, socialism itself. Chinese legal scholars have evidenced interest in creating an administrative law in China that would use quasijudicial or judicial bodies to control arbitrary cadre behavior. The problem is endemic in Chinese society, and the use of courts suggests that Party self-discipline has been recognized as inadequate. How far the courts will be allowed to participate remains in doubt.

4. LINKS BETWEEN THE COURTS AND CURRENT POLICIES

Unlike the Anglo-American model in which courts are theoretically impartial agencies for adjudicating conflicts, Chinese courts under the Communist Party have been seen and used as active participants in the implementation of Party and state policies. As in all other Chinese governmental activities, it has long been common to announce publicly the principal current policy goals which the courts should aim to realize, and to link their work with implementing those policies. For instance, Chinese judicial priorities were stated by Jiang Hua, the President of China's Supreme People's Court, in the People's Daily of April 9, 1980. He said that the four principal goals of the courts in 1980 should be to "severely punish active criminals" by taking "sterner measures against such serious criminals who commit murder, arson, robbery and rape", "check over the reverse verdicts" in cases involving the rehabilitated Liu Shaoqi, generally continue the work of "checking over framed-up, fake and wrong cases" (presumably dating from the Cultural Revolution), and "gradually put into practice the criminal law and the [criminal procedure law]".[117]

Of special interest is the extent to which the courts have been put to work in reviewing cases of political significnace. The work of reviewing cases arising out of the Cultural Revolution was given as much stress as implementing the new codes of law and criminal procedure when those codes were first promulgated—although probably most of that work was done by Party organizations. Use of the courts reflects the strong need felt by the Chinese leadership to turn squarely away from the violence and irresponsibility of the Cultural Revolution, and to right the countless arbitrary injustices

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to Heed Before the Enforcement of the New Laws", Heilongjiang Ribao, November 28, 1979 translated in FBIS November 28, 1979, S1-S2. An article in the People's Daily of January 10, 1980 complains about the refusal of "some people in charge" to carry out decisions, and said that "acts such as openly defying the dignity of law, obstructing the exercise of judicial power by People's Courts and refusing to carry out court verdicts and rulings, must be dealt with according to law. Yin Jiabao, "The Verdicts and Rulings of the People's Courts Must be Carried Out", Renmin Ribao, January 10, 1980, p. 5, translated in FBIS January 23, 1980, L10-L11.

[116] "Hongqi Denies Existence of New Class of Bureaucrats," FBIS March 31, 1981 L5.

[117] Jiang Hua, "Earnestly Perform People's Court Work Well". Renmin Ribao April 9, 1980, p. 3.

committed in the name of "correct" politics. In the course of this activity the prestige of the courts may be raised.

Since the criminal code and the code of criminal procedure were promulgated in 1980, short-term goals have been set for the courts in addition to their long-term objectives of meeting the standards set by those two laws. Of these short-term goals, there has been particular high-level emphasis on the courts punishing economic crimes.

Directives, which are treated as having the force of law, and accompanying explanatory policy statements, have explicitly called for judicial activity to focus upon economic crimes. In January 1981, for instance, the State Council issued a "circular" attempting to define illegal speculation, "profiteering" and trade in prohibited goods such as precious metals and foreign currencies, and called for a crackdown on smuggling.[118] Provincial and local instructions followed,[119] and widespread propaganda made unmistakable the leadership's concern.[120]

Reports of decisions by the courts in cases involving conduct of the type discussed in the "circular", not surprisingly, proliferated soon after it was promulgated. There had been no shortage of reports of such cases before the State Council directive, presumably reflecting the growing concern which led to that high-level expression.[121] More reports appeared around the time of the circular, such as one on the arrest and accusation of a robber who had apparently broken into Beijing's largest department store and made off with goods and cash of a total value of ten thousand yuan,[122] and the imprisonment of a Hong Kong resident for "swindling" involving forgery of a death certificate of a Chinese citizen living in Beijing who owned property in Japan.[123]

Additional measures which heightened the drive on economic crimes were a resolution of the NPC Standing Committee amending the criminal code by increasing penalties for certain crimes[124] and a decision on economic crimes issued by the Central Committee of the CCP and the State Council.[125]

The articulation of short-term goals for the courts is not new in the People's Republic of China; it has been a characteristic of law administration since 1949. However, the technique raises obvious questions about the independence of the courts. Not only is the allocation of scarce judicial resources affected, but more importantly the courts can expect to be evaluated by higher authorities on the basis of their responsiveness to demands to meet the short-term goals. It is likely that there will be heavy pressure to convict persons charged with violating currently-emphasized laws. This has certainly been true in the past. However, if a "campaign" style of justice continues to be a part of judicial administration in China, functional specialization and judicial independence of the courts will be inhibited.

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[118] "State Council Directive on Crackdown on Speculation, Smuggling," Xinhua News Bulletin, January 16, 1981, p. 6.

[119] See, e.g., "Fujian Government Issues Circular on Smuggling" FBIS February 3, 1981, P3; "Hangzhou Import Controls", FBIS January 14, 1981, O3.

[120] See, e.g., "Some Questions on Cracking Down on Speculation and Profiteering", Hongqi 1981, No. 3, in JPRS 77863, April 17, 1981, Translations of Red Flag, pp. 64-67.

[121] See, e.g., "Embezzler of Overseas Chinese Bank Savings Punished", Xinhua News Bulletin, November 14, 1980 (Local Overseas Chinese Association official sentenced to suspended death sentence for embezzling 192,800 yuan of overseas Chinese remittance and bank savings); "Liaoning Higher Court Commutes Thieves' Death Sentences", FBIS November 13, 1980, S3 (factory employee and wife accomplice sentenced to suspended death sentence for embezzling 2566 grams of gold nineteen years previously).

[122] "Beijing Department Store Robbery", JPRS 77359, Political, Sociological and Military Affairs Number 116, Feb. 10, 1981, p. 105.

[123] "Hong Kong Swindler", JPRS 77571, Economic Affairs, No. 119, March 12, 1981, p. 42.

[124] "NPC Adopts Resolution on Economic Crimes", FBIS Mar. 10, 1982, K1-K3.

[125] CCPCC, State Council Decision on Economic Crimes, FBIS Apr. 14, 1982, K1-K9.

The Chinese leadership has been sensitive to these issues. For example, a Xinhua article distinguished the drive against economic criminals from the leftist "expansion of class struggle"; [126] a decision of the Central Committee of the Chinese Communist Party and the State Council on "dealing blows at serious criminal activities in the economic field", adopted in April 1982, said in part,

> In dealing blows at serious criminal activities in the economic sphere, we are resolutely against making the work a mass movement * * * However, in dealing with major and key cases which are relatively complicated and which involve more people, we must completely follow the mass lines; that is, we must, within a definite scope, mobilize the masses knowing about the cases to factually expose and inform against those who have committed serious crimes.[127]

As the proceding quotation illustrates, some blurring of the lines between activities of the courts and of the Party continues to exist, reflected in the continued side-by-side existence of trials and administrative punishments. Thus, although the Beijing Review can say that despite the current crackdown on economic crimes, "no purge will ever happen",[128] a campaign is underway that will lead to punishment and dismissal of corrupt cadres.[129] Moreover, commitment to the system that produces the overlap continues to be expressed, and it is unlikely to be abandoned. Thus, in one explanation of the overlapping of jurisdictions, the author, in addition to arguing that Party disciplinary organizations must exercise the authority because some of the offences violate Party discipline as well as the criminal law, also argued that some of the major cases are "often confused, present relatively great complications" and, "Therefore under the unified leadership of the Party committee, the discipline and inspection organ, the judicial branch and other relevant units must join forces to carry out their respective functions".[130] Thereafter, the various organizations could mete out punishments within their own jurisdiction, and employing their characteristic substantive rules (such as the criminal code, in the case of the courts) and modes of investigation and procedure (such as the criminal trial, in the case of the courts).

Taken together, both the limits of the progress made and the tasks of the courts suggest that rapid development of the Chinese judicial system is highly unlikely. China's size, the lack of personnel trained in the law, the newness of the institutions, and the heavy impact of the Party and policy will continue to slow the separation of law from other forms of governmental activity.

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[126] "Xinhua Comments on Punishing Economic Criminals", FBIS Apr. 1, 1982, K14-K15.
[127] "CCPCC, State Council Decision," supra, note 125 at K4.
[128] "Fighting Economic Crimes", Beijing Review, Feb. 22, 1982, p. 3.
[129] See, e.g., the "CCPCC, State Council Decision", supra, note 125.
[130] "Limits of Authority in Criminal Economic Cases", FBIS, Apr. 13, 1982, K1-K2.

5. LAW AND ORDER

The Chinese leadership has evinced great concern for the need to maintain discipline and social order to protect industrialization and its incumbent institutional changes. They have been apprehensive about the new relative relaxation of political restraints, fearing that social unrest may increase. The discussion above has described the strong emphasis on using the formal criminal process to maintain order. This emphasis will have consequences for the development of China's legal system.

a. Dissidence as disorder

Much of the blame for any disorder has been attributed to the Gang of Four, and the "anarchist trends of thought they stirred up." [131] Anarchism is often equated with "extreme individualism," which has been used to describe behavior ranging from violent criminal conduct to dissent that exceeds the boundaries of whatever official policy happens to permit.[132] Thus, the banning of big character posters on Beijing's Xidan (or, as it became widely known, the "Democracy") Wall was the response, according to an article in the Beijing Worker's Daily of December 10, 1979, to attempts by some "so-called 'democracy fighters' to oppose the four modernizations, undermine stability by emphasizing certain shortcomings in our work, and attack some persons 'irresponsibly.'" The banning of posters on the wall was seen as necessary to avoid further moves toward "bourgeois liberalization." [133]

Since the well-publicized trial and conviction of dissident Wei Jingsheng, who in 1979 was sentenced to 15 years in prison for "counter-revolutionary propaganda" and revealing military secrets, debate has continued on the meaning of socialist democracy and the scope of the rights of free speech. On one hand, it has been forcefully argued that China's socialist system must be democratic enough to prevent the excessive concentration of power that lead to the Gang of Four's "fascist despostism".[134] Specifically, as one article has argued, People's Congresses must be strengthened so that they exercise genuine supervisory power, Party and Government must be further separated, power must be dispersed so that localities can exercise real political power, economic decision-making must be decentralized, "professionalization and intellectualization of the leading cadres of all levels" must be carried out, and the legal system must be improved to protect the democratic rights of the people.[135]

On the other hand, the same article argued that for the sake of maintaining social order Chinese democracy must be a disciplined democracy, which means that the centralized leadership of Party and State must be upheld.[136] "Democracy" cannot be used as a pretext by individuals to violate the basic principles of organization and discipline in China. This means that those who "understand freedom of speech as the freedom to say whatever they want to say and to do whatever they care to do in disregard of the state and the people's interests exceed the limit of the law." [137] Such persons have been warned: "We will not adopt a laissez-faire attitude." [138] Another newspaper article was more direct: "Opinions which are anti-party and anti-socialist and which sabotage the unity of the motherland and the Nationalities must be prohibited." [139] Typically, in a lengthy discussion, Red Flag, the theoretical journal of the Chinese Communist Party, went to great lengths to criticize and reject the concept of "absolute freedom of speech," which it found to be a tool of enemies of socialism.[140]

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[131] "Guangming Ribao Carries Signed Article on Anarchism", FBIS December 26, 1979, L8-L10.

[132] Ibid.

[133] "Gongren Ribao Discusses Recent Banning of 'Democracy Wall' " FBIS, December 20, 1979, L1-L5.

[134] See, e.g., "Question of Exercise of Democratic Rights Examined," JPRS 76858 November 21, 1980, Political, Sociological and Military Affairs, No. 140, p. 26; "Renmin Ribao: Feng Wenbin Article on Socialist Democracy", FBIS November 26, 1980, L23.

[135] "Renmin Ribao: Second Installment on Socialist Democracy", FBIS December 2, 1980, L9.

[136] "Socialist Democracy Requires Discipline", JPRS 77590, Political, Sociological and Military Affairs, No. 170, March 16, 1981, p. 13.

These debates are not only significant because they reflect the Chinese leadership's concern to keep democracy within bounds, but because they have potentially momentous implications for legal institutions. As the law becomes a profession in China, will judges and lawyers come to entertain views about the independence of the law that are inconsisent with the views of China's leaders? To what extent might officials whose arbitrariness has been challenged by legal institutions politicize their responses, and argue that in restraining power of officials the courts are acting to weaken the foundations of communist political power? The debate over democracy and free speech reflects issues about legal institutions which are by no means resolved.

b. Law and maintenance of social order

In the past two decades there has been an increase in social disorder, brought about by the Cultural Revolution and its disrespect for formal institutions of public order, the subsequent relaxation of political restraints, and the problems of under-employment and uncertainty about the future among the young. The problem of disorder has received continuous publicity and has stimulated a drive to strictly enforce the criminal law.

For example, an article in the Shanghai Liberation Daily on November 9, 1979 discussed the "recent rash of crime in the city which has become an outstanding problem." Counterrevolutionary activity, robbery, murder, rape, theft, public brawling, swindling, and speculation were all mentioned as common. Arrests and severe punishment of offenders were called for, and particular attention was focused on juvenile delinquency The article also criticized those comrades who "think that since we must now pay attention to the law it is not good to freely arrest and control people." [141] A campaign to limit crime followed publication of the article, and its relative success was announced in an article in the Shanghai Liberation Daily of December 18, 1979, which congratulated the police on reducing the cases of rape, gang fighting, knife attacks and robberies in the city.[142]

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[137] "Renmin Ribao: Article on Freedom of Speech", FBIS Feb. 17, 1981, L4.

[138] Id., at L5.

[139] "Gongren Ribao: "Article on Freedom of Speech", FBIS March 30, 1981 L13 at L15; see also "People's Daily Editorial on Socialist Democracy", Xinhua News Bulletin, Feb. 8, 1981, p. 108; "No Freedom of Speech for Counterrevolutionaries", Beijing Ribao, FBIS May 25, 1981, K10.

[140] "Honggi, Article Discussing Freedom of Speech", FBIS April 27, 1981. K16.

[141] "Shanghai Jiefang Ribao Stresses Public Order", FBIS December 4, 1979, O2-O5.

The problems of public order and the strict punishment of offenders needed to meet the problems have been frequently emphasized in the media. Severe sentences meted out by courts have been given wide publicity, and open trials, rallies at which sentences have been announced, and executions have received similar treatment.[143] Courts have been praised for expeditiously handling serious cases: one Shanghai court was cited for taking only 9 days to conclude the trial of an armed robbery case."[144] The need to punish serious crimes quickly was cited by the Deputy Director of the Legislative Affairs Commission of the NPC Standing Committee as a principal reason for temporarily suspending the section of the Code of Criminal Procedure which requires that all death sentences must be approved by the Supreme People's Court.[145]

Considerable publicity has been given to efforts to strengthen police control over crime: For instance, a national "urban security conference" was held in Beijing at the end of November 1979. The conference called for mobilization of the masses and consolidation of the neighborhood apparatus of control to deal with the deterioration of public order.[146] A Public Security work meeting followed in January, 1980, which emphasized strenghtening of public security within economic enterprises and cultural and educational departments.[147] In addition provincial and local public security conference are often held.[148] *People's Daily* editorials have hailed the heroism of the police in fighting crime.[149] Chinese army assistance to the police in maintaining order has been mentioned in the press on a number of occasions. [150] Special crime units have been established by the police.[151]

The response to threats to public order has also included republication of important statutes authorizing imposition of punishment by the police and administrative organizations for relatively minor crimes. Regulations on maintaining public order, originally published in October 1957, were republished in February 1980.[152] Under these regulations, the police may warn, fine, or place under "administrative detention" for limited periods of time persons who commit certain minor offenses against "public order." Also republished in early 1980 were regulations on "education through labor," first issued in 1957.[153] Under this law, offenders who fall into certain rather broadly defined categories can be punished by non-judicial departments (i.e. the police), with sentences of up to three years of "labor re-education." The original regulations in 1957 were used to authorized the confinement of many thousands of persons to labor camps for years. Conscious of such use of the law in the past, the drafters cautioned against punishing the families of offenders simply because of their relationship to persons who receive the punishment, and stated that administration of the statute would be supervised by the Procuracy.

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[142] "Jiefang Ribao Comments on Maintaining Social Order", FBIS January 3, 1980, O6–O8.

[143] See, e.g., "Beijing Vice Mayor Sees Public Security Improving," FBIS, July 10, 1981, R1 (six criminals sentenced at "mass meeting" of 18,000; "Hebei Courts Hold Rally to Sentence Murderer", FBIS, June 19, 1981, R1.

[144] "Shanghai Court Trials", JPRS No. 75732, May 20, 1980, Sociological, Social and Military Affairs No. 84, p. 86.

[145] "Wang Hangbin NPC Report on Law Interpretations Cited", FBIS, June 10, 1981, K15 at K16.

[146] "Peng Zhen Speaks at National Urban Security Conference", FBIS, December 13, 1979, L2-L4.

[147] "Public Security Ministry Holds Work Meeting", FBIS, February 6, 1980, L2.

[148] See, e.g., "Shanghai Criminal Cases", JPRS No. 76910, Political, Sociological, and Military Affairs No. 142, p. 89. "Gansu Leaders Comments Public Security Forum", FBIS Jan. 28, 1981, T1.

[149] See, e.g., "Renmin Ribao Editorial on Strengthening Public Security Work", FBIS May 9, 1980, L16-L19.

[150] See for example, "Renmin Ribao on role of PLA Units, Social Order" FBIS January 24, 1980, L1; "Anhui PLA Units Maintaining Social Order", FBIS January 15, 1980, O1; "AFP Describes Shanghai Patrols that Keep Order" FBIS Feb. 20, 1981, 02-03.

[151] "Special Crime Squads Established in Beijing", FBIS Feb. 13, 1981, L5.

[152] "Beijing Papers Republish Regulations Governing Offenses Against Public Order", Xinhua News Bulletin, February 24, 1980, pp. 32-33.

It is important to emphasize that even in the midst of the attacks on crime, warnings have cautioned on the need to observe both substantive and procedural requirements. For instance, in 1980, the President of the Supreme People's Court, Jiang Hua, told the National People's Congress (NPC) Standing Committee:

> The criminal law and the law of criminal procedure promulgated by our country have attracted the attention of the world. Whether they can be implemented to the letter is a matter of great importance concerning whether we can win the trust of the people. We must strive to enforce the law.[154]

The report of one provincial public security conference, after praising the police for their efforts to preserve social order, criticized the small number of policemen who "go in for actively extorting confessions under torture or indulge in bribery and corruption."[155] During the summer of 1981, in the midst of great emphasis on the need to punish criminals serverely, a number of newspaper articles distinguished the current policy from past political campaigns, and urged that the distinctions between serious and minor crimes must be observed in sentencing, and that the excesses of past campaigns must be avoided.[156]

It remains too early to tell which of the currents identified will prove to be the strongest. The emphasis on intensifying use of the formal criminal process from time to time in order to support particular policies is only one, albeit major, illustration of the use of law to serve of policy, consistent with such use since the People's Republic was established. At the moment, current doctrine holds that such an instrumental conception of law flows from Party leadership over both the enactment and enforcement of law.[157] At the same time, stress on the limits on official conduct set by the Criminal Law and the Law on Criminal Procedure is stronger than similar cautions in the past. Here, Chinese law faces a dilemma: Policy calling for severe punishment of criminals may sometimes encourage arbitrariness and inattention to procedural guarantees and requirements. The explicit recognition of this danger is encouraging. The policy may also affect the reputation of the courts among the populace. The architects of China's legal system will have to ask themselves whether requiring law and the agencies of law enforcement to carry out specific and changing policies will detract not only from the independence of the Chinese courts, but also from the respect which the courts will be shown by the Chinese people.

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[153] "Beijing Papers Reprint Regulations on Reform Through Labor", FBIS February 27, 1980, L1-L2.

[154] "Listening to Explanations of Implementing the Law of Criminal Procedure in Stages", Guangming Ribao April 12, 1980, p. 1.

[155] "Hubei Holds Public Security Work Conference", FBIS January 6, 1981, P2.

[156] "Renmin Ribao Article on Convicting Criminals", FBIS June 25, 1981, K21 at K22: "To carry out the principle of dealing heavy and quick blows does not in any way mean that we should adopt the method with which we carried out political movements in the past . . . we should not regard old historical cases as current cases and . . . neither should we willfully change the nature of the offensee and unscrupulously establish changes for the purpose of dealing heavy blows."

[157] "Firmly and Correctly Carry Out the Policy of Dealing Heavy and Swift Blows according to Law," JPRS 80210, March 1, 1982, Red Flag, No. 24, December 16, 1982.

IV. CONCLUDING SPECULATIONS

A. Some Functions of Law in China

It seems possible to identify distinct functions which the new institutions are expected to perform. The discussion which follows is preliminary and the functions discussed here are the most obvious.

1. LAW IN SUPPORT OF DISCIPLINE AND DEFENSE OF SOCIAL ORDER

It is clear that the formal process and other related institutions, such as the low-level mediation of civil disputes, are intended to reinforce the discipline viewed as necessary to economic modernization. Punishment of criminals who threaten the physical security of China's citizens is needed to make Chinese society physically safe. Punishment of economic crimes reinforces financial discipline and assures that the hard-earned gains of economic activity will not be diverted into the pockets of the corrupt; smuggled goods will not be allowed to poison Chinese life.

To a certain extent, the leadership seems to expect the formal legal system to do considerably more than help maintain order. A greater activism is required by the courts, judges are expected to be responsive to current policies such as punishing criminals guilty of disrupting social order and economic criminals such as venal officials. The courts are expected to march in step with the rest of China's officialdom to carry out whatever policies are viewed as necessary to stimulate further progress toward modernization. This requirement, however, will inhibit the development of professionalization, functional separation from the administrative hierarchy, and the growth of judicial independence. It will retard the development of universalism in Chinese law, as long as the gravity of punishments meted out by the courts vary with the campaigns headlined in the Chinese press.

2. LAW AS AN INSTRUMENT TO PUNISH OFFICIAL MISBEHAVIOR

It may be that subtle but important innovation is appearing in the current use of the courts to punish officials. Punishing officials for economic crimes or for malfeasance in office by subjecting them to trial has been done before, particularly during the campaign against corruption of 1953. During that campaign, specialized temporary tribunals were created; today the use of such reflections of the "mass line" have been eschewed. What appears noteworthy about more recent judicial activity—and here only an impression is offered—is that the tone is more measured, less related to the intensity of a mass movement, and relatively more reflective of regularity in the proceedings. Extending judicial activity in this area in an unfrenzied manner would enhance the importance of the courts in China's political life. Such judicial activity, if it becomes institutionalized and perceived as meaningful in controlling official arbitrariness, would also reinforce popular belief in the integrity of the pretrial system.

However, at this juncture, the prospects for institutionalizing judicial review of allegedly arbitrary administrative acts are not yet encouraging. Some confusion may be expected to arise from the clash of mutually inconsistent functions. On the one hand, judicial activity is supposed to reinforce discipline. Decisions regarding the extent and manner of discipline are made by officials of the state and the Party. They must be heeded so that policy is implemented and modernization assisted, or else disorder—and perhaps anarchy—will appear. Yet these same officials may also be the targets of accusations of corruption or of misconduct in office. How can they carry out their responsibilities if the police and courts are interfering in their affairs? This inconsistency will not be easily resolved.

The formal legal system is also involved in retrospective investigations into alleged official arbitrariness, in the form of alleged past injustices. Some of these were committed during the Cultural Revolution but others date back more than 20 years. These investigations are probably well regarded by many citizens even if they may not be personally affected by it; such investigations conducted under the aegis of the formal legal system thus enhances the reputation for fairness of the leadership and the system itself. Yet at the same time observers cannot help but wonder how long these investigations will continue. Officials who are charged with complicity in these past defenses must be anxious to have the courts cease investigating their past activities.

3. LAW AS A SOURCE OF RULES ON WHICH INDIVIDUAL AND ORGANIZATIONAL EXPECTATIONS CAN BE BASED

The new concern for regulating the economic activity of enterprises is likely to produce legal rules which are more complete than the ad hoc legislation common since 1949, expressive as it may be of a conscious effort to enact an integrated and internally consistent set of rules. A consequence of this activity may be an increase in the stability of expectations of the actors in the newly decentralized economy, such as factory managers. If they perceive such an increase in stability of expectations, it would have an impact on the personal lives of the individuals in the economic enterprises affected: they will be able to more clearly determine the consequences of their conduct in their organizational unit.

Moreover, to the extent that attempts are being made to control official arbitrariness, individuals may come to have higher expectations of stability in their personal lives. China's new marriage law, for instance sets the minimum age at which men and women may marry at 22 and 20 respectively. For many years before it was enacted, ordinary Chinese citizens did not know when they could marry, because the former law, which fixed the ages at 20 and 18, had fallen into disuse; the practical answer, for instance, to the question of when workers in a factory could marry lay in the discretion of the factory management, more likely the Party Secretary.

One day in Beijing in 1978, a taxi driver and this author discussed what we both perceived to be a new emphasis on law in the media. Quite spontaneously he spoke of the need for certainty in the lives of China's people, and complained at great length about the injustice of not knowing when he could marry until the Party Secretary of his organization told him. "There ought to be a law", he said, "that tells us when we can marry". To some extent, it would appear, the Chinese leadership is now responding to a widespread desire among the Chinese populace for greater certainty.

It is in this light that efforts to revise the Constitution should be seen. In late April 1982, the text of a proposed new Constitution was published which gives less prominence to the role of ideology and the Party, more to the structure of the state, and affirms citizens' basic rights, including property rights.[158]

B. The Uncertain Future

It is easier to discuss China's new and evolving legal institutions than it is to describe a legal *system.* Most of this article has been concerned with institution-building and related problems because China is in a state of transition in trying to fashion a role and a place for law.

Enough has been said here to indicate that law-making has begun on an impressive scale. At the same time, the resources available for legal education and the staffing of Procuracy, courts and the lawyers' associations remain limited. A more basic problem is one of attitudes: once the institutions are established, can or will the necessary attitudes needed to support relatively more autonomous functioning of these institutions be fostered among the Party and the people? It is too early to tell, of course, but the challenge posed to the efficacy of Chinese law is enormous.

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[158] Unofficial translations of the new Constitution are found in FBIS Apr. 21, 1982, K1-K24 and Beijing Review 1982, No. 19, May 10, 1982, pp. 27-47. Compare these texts with the 1978 Constitution, a text of which is found in Documents of the First Session of the Fifth National People's Congress of the People's Republic of China, Beijing; Foreign Language Press, 1978, pp. 125-172.

Among many significant features of the new Constitution, several stand out clearly. First, except for the preamble, there is no mention of the Communist Party, Marxism-Leninism, or Mao Zedong. Second, the section on "Fundamental Rights and Duties of Citizens" comes before the section on the "Structure of State" (reversing the order in the 1978 Constitution.) Even more importantly, Article 32 in the section on "Rights and Duties of Citizens" states, "All citizens of the People's Republic of China are equal before the law. The rights of citizens are inseparable from their duties." Such a statement is not found in the 1978 Constitution.

In addition to the provisions in the 1978 Constitution on the inviolability of persons, homes and correspondence, which are strengthened in the 1982 version, the 1982 Constitution stipulates that personal dignity is also inviolable (Article 37). At the same time, although rights and duties of citizens are more clearly spelled out in the 1982 version, the constitutional right to strike (in Article 45 of the 1978 Constitution) has been removed. However, the duty of citizens to pay taxes has been added (Article 53 in the 1982 Constitution).

The 1982 Constitution also evinces a much greater concern with property than its predecessor. Ownership rights are more clearly stated; and Article 15 protects the right of individuals to inherit private property. Article 12 notes the new foreign economic presence in China in a provision that "All foreign enterprises and other economic organizations, as well as joint ventures . . . in China, must abide by the laws of the People's Republic of China. . . ."

Among the provisions on the Structure of the State, a new auditing body is to be established in the State Council and at lower levels of government to verify and supervise financial activity. They "are subject to no interference by any other administrative organs or any organizations or individuals," (Article 92). Similarly, it has been specified that People's Courts and People's Procuratorates are not "subject to interference by administrative organs, organizations or individuals," (Articles 128 and 133). It should be noted that this fails to specify that the Party should not be involved in these areas.

The problem is nationwide and extends to all segments of society. Officials have heretofore not felt constrained by the courts when they formulated or implemented policy, and the populace has not looked to the law as a means of regulating official conduct or of defining or assuring their expectations. The problems of distinguishing law from policy, from discipline and from administration—as, for instance, in the administration of public order—derive from historical lacunae in Chinese culture and policy, and have been deepened by the last thirty-odd years of Communist rule.

It is difficult to predict how, given Party practices and attitudes, China's officials will solve the problems of establishing a legal system and managing its subsequent growth. For instance, the architects of China's legal system may find that the institutions they have created may take on an appearance which they had not intended. Commentators who write and speak in public about the function of the legal system emphasize the role of law in protecting discipline and order. This is consistent with previous Chinese (and Soviet) discussions which stressed, as has been mentioned earlier, discipline rather than the creation and assertion of individual rights. Moreover, as has also been noted above, emphasis on individual rights, especially based on law, was weak in traditional China.

But the new legal system has already had to formally recognize rights which belong to individuals and which are allegedly protected by the law. Current theory emphasizes limits on those rights, which must be exercised only in a manner consistent with the interests of socialism and the people; it goes without saying that these interests are defined by the leadership and lower-level officials carrying out their instructions. However, by promoting the growth of the legal system China's leadership is also stimulating a new hospitability to individual rights, which, if the legal system flourishes, might some day be asserted to challenge some of the basic notions of a Communist state. Already rights under the Constitution have been asserted and rejected, as the case of Democracy Wall shows.

Moreover, the resilience and tenaciousness of the Chinese bureaucracy, which has not welcomed the creation of vigorous legal institutions in the past, promises to cause obstacles to the growth of legal institutions today. The impact which the law may make on the bureaucracy remains in issue. Chinese discussions reflect considerable concern with the persistence and harmfulness of certain traditional practices of Chinese bureaucrats, Communist or otherwise. These are not unique to China, of course, but are endemic to developing countries.

Indeed, recent Chinese efforts to create a legal system dramatize the fact that China has not yet solved problems common throughout the Third World. For instance, Gunnar Myrdal has observed, corruption reflects the weakness of loyalty to the community, especially to a national community; it implies a "low level of social discipline", and is characteristic of the "soft state", in which loyalties based on networks of local and individual relationships have not been transcended by a strong sense of obligation to the community.[159] It may seem odd to regard China, so often thought of even very recently as a remarkably disciplined Communist society, as sharing the problems under discussion here with other Asian nations which have not experienced vigorous economic development, such as Burma. The success of Chinese Communism in focusing the allegiance and loyalty of hundreds of millions of Chinese on the Chinese Communist Party and on the nation which the Party has created has sometimes served to obscure the persistence of the smaller loyalties, the little networks of personal influence, that preceded Communist rule and continue to exist in China today. Mao recognized the extremes and dangers of such smaller loyalties within and despite the Communist Party, and all but destroyed the Party trying to reform it. In the wake of the Cultural Revolution and subsequent shifts in policy, some of the values on which Chinese Communist political and economic accomplishments were based have been weakened. Nationalism and Chineseness continue to appeal to many Chinese, but belief in the wisdom and altruism of Party and officials and in the need for individuals to make sacrifices now for the future greater collective good have eroded.[160] In the midst of what may well be a crisis of values, it is not surprising that selfishness and unwillingness to be self-sacrificing for the collective should emerge.

Legal rules, while hardly the objects of the kind of fervent belief that a political ideology can inspire, can have unifying effects even if such effects are clearly discernable only over a long period of time. Legal rules possessing nationwide validity and which are perceived as being objective both in content and in enforcement provide codes of behavior which transcend particularistic relationships and private allegiances. These views are not new, of course. What is new is that it has now become appropriate for the first time in the history of the PRC to consider Chinese law from the aspect of criteria of modern legal systems.[161]

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[159] See Gunnar Myrdal, Asian Drama: An Inquiry Into the Poverty of Nations Vol. II. New York: Pantheon, 1968, pp. 895-900, 937-958.

[160] See, e.g., "Nanfang Ribao Discusses Protection of Criminals", FBIS Mar. 6, 1982, p. 1, charging that some people protect accused violators of law and discipline because "they have forsaken the principle of party spirit and placed personal feelings and private interests above the interests of the party and the people."

[161] It is possible to define a "modern legal system", as comprised of institutions intended to be

(1) bureaucratically and hierarchically organized, administered according to rational procedural rules, staffed by professionals, and functionally separate from other institutions of society; and

(2) administering rules intended to express general standards of universal applicability, and uniformly applied in apportioning rights and obligations arising out of particular acts or transactions.

This working definition incorporates most of the elements of the model of a modern legal system stated in Marc Galanter, "The Modernization of Law", originally published in Myron Weiner, Modernization, p. 153 (Basic Books, New York, 1966), reprinted in Lawrence Friedman and Stewart Macaulay, Law and the Behavioral Sciences, pp. 1046, 1047-48 (2nd Ed., Bobbs Merrill Co., Inc., Indianapolis and New York, 1977).

This model is relevant now because the stated goals of the architects of the system indicate that they intend the system to be "modern" in the sense of the model, i.e. that its characteristics are suitable for China. The discussion in this essay should make plain that such a model only in a very limited fashion to measure the Chinese system as it operates today. It is still unclear how much of a commitment will be made to assure steady progress toward the "modernity" of law which is a declared objective of the system today.

It is impossible to predict today how distinguishable the legal instutitions will become from others, and what autonomy they will eventually be allowed to enjoy.

Whether substance will be given to the legal forms is impossible to predict. It is still too early to tell, for instance, whether the heightened use of criminal prosecution will threaten to turn the courts into hardly-disguised arenas for a campaign, however salutary the goal. From the forms must emerge legal rules and regular procedures for articulating and implementing them, if China is to have a "modern" legal system. Growth is likely to be uneven, and some areas may mature faster than others, making of China law separate sub-systems entering at different rates of institutionalization with different prospects for success.

One close observer has written,

> The institutionalization of the legal system isn't a panacea for China's problems. Pinning too much hope on the law will lead to disillusionment. But without law, China's chances of becoming a modern society are small, and Chinese leaders clearly know this.[162]

Another provocative student of Chinese politics is skeptical:

> * * * in Chinese politics the two traditional limitations on power, law and customs, are missing. And the prospect is that power is likely to become even more important because the rather fragile Communist form of restraint, that of ideology, will probably erode faster than a system of law can be established.[163]

At this moment in the legal history of the PRC, legal institutions and legal doctrine are still less important than forces outside the law that shape both legal rules and the institutions charged with giving them life.

V. THE ROLE OF LAW IN REGULATING FOREIGN TRADE AND INVESTMENT

If the expansion of the role of law to govern relations between Chinese citizens and the state and relations among Chinese individuals and organizations marks a noticeable change from the past, even more extensive change has occurred in the use of legal rules to govern economic relations with foreigners. This section discusses the use of law to translate the new policies into practice. Formerly, the China trade was conducted virtually in a legal vacuum. Transactions were negotiated and simple contracts drafted and signed almost without reference to any legal system, Chinese or otherwise. The major reason for this was that the China trade was limited largely to buying and selling goods which were delivered in boxes or bales. The modalities of these simple transactions were determined by very simple contracts and the accretion of contract practice. Since 1978, however, ambitious innovations leading to greater Chinese participation in the international economy have been made.

China, now newly anxious to import foreign technology and know-how on a large scale, has become hospitable to foreign direct investment; new "Special Economic Zones" in South China have been created in which foreigners may own up to 100% of factories manufacturing products for export; a heightened interest in technology licensing has appeared; and a wide variety of flexible counter-trade and processing transactions have been encouraged. The increased presence of foreign companies and individuals in China flowing from the above-mentioned activities has also necessitated the further development of laws dealing with questions of taxation and other aspects of expatriate life. These new policy initiatives have meant that China must create a whole new area of Chinese law. China's leaders have responded to the new need by causing to be promptly promulgated new laws and regulations that promote and regulate foreign trade and investment activities while protecting China's interests and sovereignty. These laws, enacted in a relatively brief time-span at a rapid rate, express the intent of the Chinese leadership to establish basic rules on such subjects as equity joint ventures [164]; the Special Economic Zones [165]; taxation of equity joint ventures, income of individual foreigners earned in China, and China-source income of foreign companies engaged in economic activity other than investment in equity joint ventures [166]; exchange control [167]; litigation involving foreigners [168]; offshore oil exploration [169]; and others [170].

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[162] Frank Ching, "China's Crackdown on Economic Crimes", Asian Wall Street Journal, March 18, 1982, p. 6.

[163] Lucian Pye, The Dynamics of Chinese Politics, p. 128, Oelgeschlager, Gunn & Hain, Cambridge, Mass., 1981.

Limitation of space prevents detailed discussion of the provisions of the laws themselves, but it may be helpful to consider some problems which have arisen in connection with them.[171]

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[164] Laws relating to joint ventures in general include "The Laws of the People's Republic of China of Joint Ventures Using Chinese and Foreign Investment," FBIS, July 30, 1979, Supplement No. 20. pp 31-35; "Regulations on Registration of Joint Ventures Using Chinese and Foreign Investment," China Economic News, September 9, 1980, Supplement No. 5; and "Regulations on Labour Management in Joint Ventures Using Chinese and Foreign Investment," Chinese Economic News, Sept. 9, 1980, Supplement No. 5.

[165] Laws relating to Special Economic Zones include "Regulations on Special Economic Zones in Guangdong Province;" "Provisional Entry/Exit Regulations for the Guangdong Special Economic Zones;" and "Provisional Regulations for Business Registration for the Guangdong Special Economic Zones;" "Provisional Labour and Wage Regulations of the Guangdong Special Economic Zones;" and "Provisional Land Regulations the Shenzhen Special Economic Zones." Texts of these laws are found in Ordinance and Regulations: Guangdong Special Economic Zones, Hong Kong: Ta Kung Pao, 1982.

[166] Among the many tax laws and regulations recently promulgated are: "The Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment," Xinhua News Bulletin Sept. 17, 1980, pp 14-17; "Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment," Xinhua News Bulletin, Dec. 17, 1980, pp 11-18; "The Individual Income Tax Law of the People's Republic of China," Xinhua News Bulletin, Sept. 17, 1980, pp 10-14; "Detailed Rules and Regulations for the Implementation of the Individual Income Tax Law of the People's Republic of China," Xinhua News Bulletin, Dec. 17, 1980, pp 19-24; "The Foreign Enterprise Income Tax Law of the People's Republic of China," FBIS, Dec. 17, 1981, K1-K3; and "Detailed Rules and Regulations for the Implementation of the Foreign Enterprise Income Tax," China Economic News, Mar. 8, 1982, pp 2-7.

[167] "Provisional Regulations for Exchange Control of the People's Republic of China," FBIS, Jan. 6, 1981, L8-L13; "Rules Governing the Carrying of Foreign Exchange, Precious Metals, and Payment Instruments in Convertible Currency into or out of China," FBIS, Aug. 11, 1981, K4-K6; "Rules for the Implementation of Exchange Control Relating to Foreign Representations in China and their Personnel," FBIS, Aug. 11, 1981, K6; "Detailed Rules and Regulations on Exchange Control Relating to Individuals," FBIS, Jan. 8, 1982, K7-K8; and "Detailed Ruling on the Examination and Approval of Applications for Foreign Exchange by Individuals," FBIS Jan. 8, 1982, K8-K9.

[168] "Civil Procedure Law of the People's Republic of China, part V" in JPRS 80370, Political, Sociological and Military Affairs, No. 283, Mar. 22, 1982.

[169] "Regulations of the People's Republic of China on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises," FBIS, Feb. 11, 1982, K4-K9.

[170] See, *e.g.*, "Provisional Regulations on the Control of Resident Representative Offices of Foreign Enterprises in China," FBIS Nov. 25, 1980, L36-L39.

The new laws were drafted quickly but the consistency of their implementation has sometimes been slowed by the immensity of the task of creating clear rules where none existed before. For instance, aware of the desire of prospective foreign investors for a legal framework defining the rules applicable to their investment, the Chinese moved quickly to enact the law on joint ventures. However, given the novelty of the institution in China, the need to integrate it into a socialist planned economy and the lack of experience of legal and trade personnel in this kind of endeavor, the joint venture law is understandably extremely brief and very general. As a result, however, it can only give the most general guidance to investors and to Chinese officials alike. The same is true of the laws on taxation. Additional "regulations" on joint ventures and on taxation followed the promulgation of the laws themselves, but these are incremental additions to a growing framework which cannot quickly be made comprehensive. Sometimes supplemental regulations have raised questions by apparently departing from the meaning of the laws they are supposed to interpret.

More fundamental problems have been caused by uncertainties and changes in the policies on which the new laws are based. For instance, the law on joint ventures explicitly contemplates the possibility that some joint ventures may sell some of their products on the domestic Chinese market as well as abroad. However, "readjustment" as it was interpreted after promulgation of the law, has emphasized earning foreign exchange through exports. In practice, as a result, foreigners trying to negotiate on joint venture projects have encountered considerable opposition from the Chinese side to selling within China.

Another example of inconsistency and uncertainty in policy has been the issue of fringe benefits to workers in equity joint ventures. Chinese state-owned enterprises provide a wide range of benefits to their workers including subsidized housing, meals and transportation, child care and others. Conversations with officials of the Foreign Investment Control Commission in Beijing[172] have indicated that they intend the joint ventures to pay for all of the benefits which the workers receive. In effect, this means that the foreign partner will bear that burden or most of it, since the foreign side will in practice put up all or most of the funds contributed to capital. However, no uniform method of calculation or list of benefits has been available. In one negotiation in which this author participated in a city outside Beijing, the Chinese side insisted that the joint venture's bill for benefits should amount to 60 percent of the total wage bill. However, a subsequent discussion with the Foreign Investment Control Commission revealed that its policy, as expressed in an internal directive which could only be orally summarized but not shown to foreigners, required the benefits to equal 122 percent of the wage bill. Even higher figures have been suggested in other negotations in which this author has participated. The specific problem which caused the uncertainty is likely to be dealt with in regulations on the subject, but the general problem—changes in policy deemed to affect the law—is not likely to disappear.

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[171] Foreign commentary is either preliminary, uneven, or both. Typically, initial studies are exegetical, followed later by accounts and comments discussing newly accumulated experience. On the joint venture laws see, e.g., Torbert, China's Joint Venture Laws A Preliminary Analysis, 12 Vand J. Transnat'l L. 819 (1979); Stanley B. Lubman, "China's Joint Venture Laws Leave Questions Unanswered," Lubman, "Policy and Administration Unclear in China's Law," Asian Wall Street Journal; November 7 and 9, 1980; David A. Hayden, "Foreign Partners Problems in Joint Ventures in China," Asian Wall Street Journal, June 30, 1981 and July 1, 1981; Pattison, "Special Economic Zones in the People's Republic of China", China Law Reporter, Vol. 1, No. 3 (Spring 1981) p. 144; Timothy A. Gelatt, "Laws for China's Economic Zones are Unclear," Asian Wall Street Journal, Feb. 10, 1982, p. 4; and *idem*, "Land, Entry Laws in China's Economic Zones," Asian Wall Street Journal, Feb. 11, 1982, p. 4.

On taxation, see Richard D. Pomp, Timothy D. Gelatt and Stanley S. Surrey, The Evolving Tax System of the People's Republic of China, 16 Texas Int'l. J. 11 (1981); Owen D. Nee and Franklin D. Chu, "China's New Taxation Laws: The Implication for Foreigners," "China's New Taxation Laws: More on the Nuts and Bolts," and "China's New Taxation Laws: The Who and What of an Individual's Income," Asian Wall Street Journal, Feb. 24, 25, and 26, 1981, John P. Beukema and Timothy A. Gelatt, "China's Income Tax Laws for Foreign Enterprises," Asian Well Street Journal, Mar. 8, 1982, p. 6; and idem, "How China's Tax Laws May Affect Some Industries," Asian Wall Street Journal, Mar. 9, 1982, p. 6.

[172] This organization has since been placed under the jurisdiction of the Ministry of Foreign Economic Relations, the successor to the Ministry of Foreign Trade in a comprehensive bureaucratic reorganization in early 1982.

It has been difficult for the Chinese to impose nationwide uniformity of interpretation of the new laws. This was even true after 1978 on a question that previously had hardly ever been put in issue by any foreigners in the China trade, namely the basic authority of Chinese negotiators to enter into and approve transactions with foreigners. The decentralization of foreign trade and the resulting new autonomy of provinces, some cities, and some factories, as well as new corporations created by ministries to engage in foreign trade, created a diffusion of authority that promises to be permanent, even if the extent may vary. Considerable differences of opinion between local and central authorities have appeared about the type of transactions which required high-level central approval. Lack of such approval has caused some agreements to be cancelled: One contract with a foreign company to construct a petro-chemical plant in Beijing was cancelled in 1980; one of the reasons given for cancellation was that the Beijing municipal authorities had failed to obtain approval of the contract from the State Capital Construction Commission. Nor has the lack of uniformity simply been along local-central lines. In Beijing in one negotiation of which this author has knowledge, one ministry has asserted that wage levels in joint ventures established by the appropriate regulations didn't apply to the transaction in question—without stating any reason.

The tentativeness, policy changes, and lack of uniformity noted above will necessarily bedevil any attempt by foreigners to ascertain the applicability of Chinese law to their activities. The confusion is likely only to be abated rather than dispelled as the new laws for which many foreigners have clamoured continue to appear. Because foreigners are intimately affected by these laws and come into regular contact with them, they should be keenly aware their problems reflect the nature of the Chinese legal system. The characteristics of the sector of the laws applicable to foreigners are but characteristics of the new uses of law generally.

Moreover, it is difficult in the light of the past to see how the results of recent Chinese law-making efforts could be otherwise: The same lack of use of legal rules that has prevailed in domestic activity has stamped foreign trade. The newness of some of the institutions (such as the joint venture) which have been created, lack of trained personnel to draft and implement the new laws, and the strength of past practice which largely ignored formal legal rule further complicate the making and implementation of rules applicable to foreign economic activity. Although foreigners may feel that their problems with the Chinese legal system as it affects foreign transactions may be unique, in fact, they are only the most visible examples of the tasks faced and problems encountered by the entire legal system.

RECENT DEVELOPMENTS IN CHINA'S TREATMENT OF INTELLECTUAL PROPERTY

By Michael Kirk and David Denny*

At the present time, Chinese leaders are contemplating significant changes in their treatment of intellectual property. New patent and copyright legislation and amendments to China's trademark legislation are in the works. Moreover, interesting reforms forecasting these new legal systems have been introduced and are already affecting China's technology transfer activities.

The Chinese have completed a draft of a patent law that, if passed, will mark a bold departure from past Chinese policies. In addition to continuing to utilize a system of "inventors' rewards" Chinese socialist organizations would be permitted to patent their inventions and to charge royalties for use of their patented inventions. Moveover, private enterprises (individuals and joint ventures) would be granted the full range of patent rights. While no fundamental changes in Chinese trademark law are under consideration, the Chinese are considering improvements to their law.** Moreover, Chinese planners have recently promoted competition and brand name identification among Chinese enterprises and have even encouraged advertising to promote these goals. Finally, work has begun on a copyright law, which, as expressed by the drafters, will qualify the People's Republic of China for membership in the Universal Copyright Convention.

As with other changes being discussed in China today, the ultimate outcome is still quite uncertain. While it seems clear that the dominant group in Beijing today supports these changes, it is equally clear that the new ideas do not have the full support of many prominent and influential individuals and organizations. More importantly, the reintroduction of some important aspects of a more or less traditional patent system and the establishment of a copyright system will set into motion forces whose ultimate consequences must be difficult even for Chinese planners and theorists to foresee.

The reasons for adopting new intellectual property laws are fairly easy to discern. First, despite some political twists and turns, the general trend in China for the past few years has been to encourage more individual creative activity. Secondly the present leadership has placed a high priority on economic development and the modernization of science and technology. To achieve that goal, previous ideological restraints on material rewards and private ownership have been moderated. Thirdly, the Chinese are experimenting with potentially far reaching changes in economic organizations that would allow basic level economic units more flexibility and authority in making decisions. Finally, China's economic and political policies have pushed China towards a more intimate involvement with foreign countries. All of these factors have forced China to undertake a rather thorough reevaluation of its laws and policies on industrial and intellectual property.

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**See footnote 24b.

I. CHINA'S TREATMENT OF INTELLECTUAL PROPERTY FROM 1949 TO 1976

Throughout the 1950's, China retained many features of traditional intellectual property protection laws. The reasons were two fold. First, during this period a substantial part of Chinese economic activity had not yet been brought under the state plan. Thus, laws encouraging individual innovative activity were still necessary. Secondly, Chinese planners were influenced by the Soviet system which has always maintained some important features of traditional copyright, patent and trademark systems.

Following the nearly complete socialization of the economy during the 1950's, the Sino-Soviet split in the early 1960's and the series of increasing radical campaigns against bourgeois attitudes, which began during the Great Leap in the late 1950's and culminated in the Cultural Revolution in the 1960's, Chinese policy towards intellectual property was radicalized. Copyright protection for Chinese authors, which had been considered in the early 1950's, was never introduced. Trademarks were retained only to impose a sense of responsibility in Chinese enterprises to maintain quality standards. Chinese inventors lost any semblance of control over their inventions and their monetary rewards were sharply reduced as well.

The most important reason for rejecting laws and institutions that protected intellectual property was ideological and political in nature. On the one hand, the Chinese revolution had, as Hsia and Haun emphasize, a strong "anti-elitist" bias and this "anti-elitist ideology has been a major force in shaping the PRC's legislation regarding industrial and intellectual property".[1]

On the other hand, the peculiarly optimistic strain in Mao's belief in the malleability of human nature provided an ideological basis for believing that material incentives were unnecessary. As Hsia and Haun put it:[2]

> Each person in the higher phase of communist society would realize and act in accordance with his or her social essence. . . . Emphasis upon individual differences would be supplanted by awareness of common humanity.

Traditional forms of intellectual property protection are understandably difficult to reconcile with radical communism. The social justification for private ownership and control over inventions and ideas lies in the belief that the person has performed a uniquely heroic individual act which "transcends the prior art of the relevant field of human knowledge."[3] For the more radically inclined Chinese, however, even more than other Marxists,[4] inventions were merely another form of social activity which did not justify assigning any special "natural rights" monopoly to the inventor.

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[1] Ta-tai Hsia and Kathryn Haun, "Laws of the People's Republic of China on Industrial and Intellectual Property", Law and Contemporary Problems, Duke University, Vol. XXXVIII, Summer-Autumn, 1973, No. 2, p. 275.

[2] Ibid., p. 275.

During the 1960's and 1970's, it was emphasized that intellectual activity was a natural result of class status. Therefore, Chinese writers explained "every mental event in terms of its relation to others, and . . . oppose[d] the psychologists' focus on individual psychological faculties." [5] During the 1960's and 1970's, when Chinese philosophers addressed the problem, they emphasized that inventive and innovative activity arises out of a process determined by the social milieu and is essentially not the result of individual mental activity: "All innovations are created by the laborers in their production struggles and scientific experiments. None emerge only from the empty thoughts of the inventor's heaven-sent brain." [6] Another key aspect of this theory is that such activity can be learned and organized: [7]

> [Our] psychologists have not only smashed the heresy of bourgeois psychology, which regards creation and invention as the products of accidental "inspiration", "sudden comprehension", and the like, but have also been instrumental in promoting creation and invention, as well as in encouraging the movement for technological reform.

Because of these beliefs, the individual creative act was not viewed as terribly important, and there was little or no justification to reward such activities with extraordinary monetary sums. The granting of monopoly power and control also threatened to bestow unacceptably high monetary rewards on a new elite. In addition, patent and copyright laws allow individuals to exert a certain amount of control over the dissemination of their inventions and ideas. This accumulation of income and power was unacceptable to China's radicals. As Hsia and Haun point out: [8]

> The Chinese since 1949 have become increasingly wary of according extraordinary rights to creative individuals by law for fear of contributing to the establishment of an elite group.

In addition to ideology and politics, there were pragmatic reasons for opposing rewards for individual intellectual activities. First of all, after most property was nationalized or collectivized in the mid-1950's, inventive and intellectual activity was generally brought directly or indirectly under state or party control. Presumably, Chinese planners believed that most inventive and innovative activity was the result of a hierarchically organized and planned decisionmaking process. Finally, after the mid-1950's, China grew increasingly estranged from the Soviet Union and then from the whole world during the most chauvinistic phase of the Cultural Revolution. Autarkic is too strong a word to apply, but for nearly 15 years between 1959 and 1972, China had neither the ability nor the desire to absorb much foreign technology. As a result, there were few pressures to conform to international standards of patent, trademark and copyright protection. Thus, the intellectual property system that PRC leaders inherited in the mid-1970's was uniquely radical even by the standards of other communist states.

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[3] Ibid., p. 276.

[4] In his 1977 book Professor Donald Munro concludes that "The Chinese diverge from other Marxists in the degree to which their orthodox line insists that all mental activities have a class nature." Donald J. Munro, The Concept of Man in Contemporary China, University of Michigan Press, Ann Arbor, 1977, p. 41.

[5] Ibid., p. 41.

[6] Ibid., p. 72.

[7] Ibid., p. 72.

[8] Hsia and Haun, op. cit., p. 290.

At this point, it is useful to describe briefly the most salient aspects of Chinese policies toward patent, copyright and trademark laws between 1949 and 1976.

Prior to the socialization and collectivization of the means of production during the 1950's, China retained a standard patent law that allowed private individuals and enterprises to use their inventions, assign or license them to others, prevent others from using them and bequeath them to heirs. In 1954, a schedule of monetary rewards for inventors was published to implement fully the 1950 system of certificates and authorship. These certificates provided financial awards in excess of $100,000 for a single invention. According to Hsia and Haun, these rewards were relatively generous in comparison with those in use in the Soviet Union.[9]

Following the failure of the Great Leap Forward and the break with the Soviet Union, however, the Chinese in 1963 eliminated the traditional features of the patent system. The new 1963 law eliminated the inventor's ability to obtain a patent: "All inventions are the property of the state, and no person or unit may claim monopoly over them. All units throughout the country (including collectively owned units) may make use of the inventions essential to them." [10] Moreover, China reduced the maximum reward for an invention to less than 5 percent of what had been allowed previously. Thus, while the initial Chinese position had been "more elitist than its Soviet model",[11] the 1963 law was much more anti-elitist and radical than the Soviet version.

While the 1963 legislation has never been formally abrogated, there are few if any references to pecuniary rewards during the Cultural Revolution from 1966 to 1976. This does not necessarily imply that no bounses were paid, but it is clear that even small financial inducements were not officially encouraged as a means to increase creative effort.[12]

Chinese trademarks had a similar meaning in China as in the West for much of the 1950's. Firms acquired the exclusive use of registered trademarks. But in 1963, the Trademark Law was revised. No mention was made in the new law regarding a right to exclusive use of a trademark—although the law-pledged that identical or similar marks would not be registered for same or similar products. There was also no provision for action against infringement. In these two aspects, the 1963 Chinese law appears to be more radical than its Soviet counterpart. In addition, Chinese trademarks have always put exclusive emphasis on the responsibility of the enterprise to maintain the quality and consistency of its products.

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[9] Ibid., p. 281.

[10] Loc. cit.

[11] Loc. cit.

[12] Two thorough reviews of the subject could not find any direct evidence of the existence of pecuniary rewards after the onslaughts on individual intellectual endeavor during the Cultural Revolution. Hsia and Haun conclude that the absence of any explicit notice of such payments indicates that the system was probably "no longer being implemented." (P. 282). Gale believes, on balance, that the system of rewards was never abrogated, and continued to play a minor role. (Barden Noel Gale, "The Concept of Intellectual Property in the People's Republic of China: Inventors and Inventions", China Quarterly, No. 74, June, 1978, p. 351 and p. 355). Whichever view is correct, it is clear that the results of the Cultural Revolution effectively dismantled most of the remaining vestiges of a system that provided effective material incentives for inventors—few of whom would have been eager to have themselves singled out for monetary rewards anyway.

Early in the Communist period, there was evidence that the Chinese intended to draft a copyright law. However, despite this initial intention, the Chinese "apparently never promulgated a comprehensive copyright statute."[13] The only available information on the rights and compensation of Chinese authors are model contracts between Chinese authors and publishers. These call for lump sum contracts based on the length of the volume and the number of copies to be printed during the term of the contract. The author agrees not to use another publisher and the publisher retains the right to revise the author's work. As of the mid-1970's the Chinese system was more "radical" than that of the U.S.S.R. and other East European states which continued to maintain copyright protection systems.[14] Moreover, the U.S.S.R. acceded to the Universal Copyright Convention in 1974.

II. Changes in the Underlying Assumptions in the Mid-1970's

Many of the basic assumptions underlying China's treatment of intellectual property have changed in varying degree following the death of Mao Zedong and the fall of prominent radicals in the fall of 1976. The key change, however, was the decision made by the 11th Plenum of the Chinese Communist Party's 8th Congress to shift the emphasis of the party's work to socialist construction. This decision made the "Four Modernizations" of agriculture, industry, defense and science and technology the priority tasks of the party. It was also apparent that party leaders were putting an enormous stress on upgrading science and technology as a precondition to achieving the modernization of the other three sectors.

The 11th Plenum decisions were as much political and ideological as they were economic. In a basic sense, the party reverted to a more traditional Marxism which Mao had gone a long way towards rejecting. Deng Xiaoping and others argued that Maoist goals such as selflessness, self-reliance of economic units, reduction in differences between manual and mental labor, and the elimination of material incentives for extraordinary achievements had been carried too far. The implication was that China's society and economy were still insufficiently advanced and that Mao's attempts to revolutionize mass psychology and social relationships before altering the economic base had been premature and counterproductive.

Since 1976, some Chinese writers have begun openly to question even more basic tenets of Maoism. Instead of placing primary emphasis on the role of class and work place relationships as the explanation for inventions and innovative activity, it has recently become more acceptable to credit individual breakthroughs. For example, a Shanghai author defended rewards for inventions by saying that: "Science and technology is a kind of mental wealth and is something of value created by complicated mental efforts, so in a socialist society in which there is still commodity production, it can only be exchanged at equal value and must not be distributed through egalitarianism and indiscriminate transfer of resources."[15]

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[13] Hsia and Haun, op. cit., p. 289.

[14] For a discussion of copyright law in the Soviet Union see S. Pisar, "Coexistence and Commerce: Guidelines for Transactions Between East and West," 1970. Pisar states that in the U.S.S.R. copyright protection "is broadly available for 'any scientific, literary, or artistic work' regardless of its form, purpose or value." He goes on to state that "the scope of copyright protection is thus virtually coextensive with that of most Western systems. A Soviet citizen enjoys its benefits irrespective of whether the eligible work is published at home, abroad, or not at all." Pp. 362-363.

Chinese radicals and "capitalist roaders" also dueled for most of the early and mid-1970's on the question of appropriate principles for workers' compensation. Chinese leftists conceded that the time was not ripe to proceed to absolute egalitarianism but insisted that "if we depart from the spirit of proletarian politics, regard 'more labor, more pay' as a 'motive force' to stimulate the enthusiasm of the masses, and put awards and work points in command we shall lead the people to take the evil revisionist road."[16]

Deng Xiaoping and his allies, of course, did not assume that man was willing to work selflessly. To them, bourgeois rights and material incentives were precisely the needed motive forces. Before Deng Xiaoping was purged for the second time in 1976, he was responsible for a draft memorandum which stated that "while restricting bourgeois rights, we must be mindful of the material and *moral* (Emphasis added.) conditions that are presently in existence. . . . We must not deny the necessity of the existence of disparities and pursue egalitarianism. Egalitarianism is not only impossible now, it is also impossible in the future."[17] Since regaining power and particularly since the Third Plenum, Deng and the present leaders have sought to expand the role of bonuses and piece rate wages. They have also used enterprise profits to reward workers, expanded the size of the free market and private plot and re-allowed individual and collective handicrafts, industrial and commercial undertakings.

The Third Plenum also resulted in a series of extremely important decisions about reorganizing the economy. This is not the place for a full review of China's recent economic reforms but it is important to describe briefly some of the important features of the program to decentralize decisionmaking to lower levels of the Chinese economy. Most importantly, Chinese planners are trying to impose a greater degree of fiscal discipline onto China's economic units. Previously, many organizations were immune to pressures to reduce their costs or increase their revenues since they "all eat out of the same pot." To relate rewards more closely to effort and effectiveness, experiments have been introduced in a large number of the most important Chinese factories. Investment resources and bonus and welfare funds will bear a relationship to enterprise profits. Direct contacts between suppliers and user entities have been encouraged and, within limits, Chinese organizations are encouraged to maximize their gains from such economic relationships. In a similar fashion, administrative entities such as municipalities and provinces have been given a freer hand to utilize their own resources to their own advantage.

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[15] Xu Guoquan, "How to View the Keeping of Technical Secrets", Wen Huibao, February 11, 1981, in Foreign Broadcast Information Service, China Daily Report (Hereafter FBIS-CHI) February 27, 1981, p. O-2.

[16] Gale, op. cit., p. 575.

[17] "Some Problems in Accelerating Industrial Development", September 2, 1975, in Chin Hsin, "The Case of the Grain of Four," Cosmos Books Ltd., Hong Kong, p. 265.

It is much too early to forecast how these reforms will fare. There is abundant evidence provided by reform proponents that the movement almost immediately conflicted with macro-economic policy and led to excessive investment and inflation. In addition, many Chinese leaders and organizations must consider such reforms to be contrary to the very essence of China's socialized and planned economy. Nevertheless, for present purposes what is important is not how the reforms will fare in the long run but the fact that they now exist as an important new experimental policy supported by the dominant group now in power in Beijing. As a result of their existence, the assumption that the Chinese economy will always be as highly centralized as in the past is no longer a foregone conclusion.

Finally, the decade of the 1970's saw China dramatically shed its previous self-imposed isolation and become a willing and even aggressive participant in the international economic community. Certainly, the primary consideration for these developments was geopolitical, but economic motivation played a role as well. Once again, the proposals drawn up under Deng Xiaoping's leadership in 1975 bluntly stated the case for foreign economic involvement: "It is necessary to learn humbly from foreign experience and to selectively import advanced technologies from abroad for our purposes. This will speed up the development of our national economy. We must stick to the principle of independence and self-reliance and oppose the philosophy of slavishly learning from abroad and crawling slowly behind. But we must not be conceited and close our doors to everything and refuse to learn at all from abroad." [18] Deng made it clear that he intended to upgrade China's own scientific and technical capability by importing technology: "All industrial ministries and science research units must firmly grasp the favorable opportunity that has been created by the success of Chairman Mao's revolutionary line in foreign policy . . . and try to learn as fast as possible the new technoligies we need." [19]

Since then China has not only greatly increased its exports and imports, it has adopted forms of international economic cooperation which would have been unimaginable only five years ago. While there was an evident slowdown in introducing further economic reforms into China's international trade system during the first part of 1981, Chinese policy in 1981 continued to encourage investment in special economic zones, joint ventures with foreign firms and the use of foreign capital to extract China's offshore petroleum resources.[20]

Closer economic and diplomatic ties with foreign countries have resulted in pressures to bring China's policies into closer harmony with the rest of the world. This has been done partly as a matter of Chinese self-interest, (as in the case of accepting low interest economic aid), and partly as a reflection of the cold reality that importing huge projects and forming joint ventures will be possible only if China moderates some of its traditional trading practices.

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[18] Ibid., p. 263.
[19] Loc. cit.
[20] See the articles in sections IV and V of this volume by John Davie and Dean Carver, and Jack Rich and Lilliana Monk and Stanley Lubman.

In some cases, the fruits of international commerce are directly linked to China's commitment to generally accepted standards of international commerce. A good example is the negotiation of the U.S.-China Trade Agreement under which China obtained most favored nation tariff treatment from the United States. By U.S. law, such a trade agreement with a Communist country requires, among other things, that countries who are not party to either the Paris Convention or the Universal Copyright Convention, must provide patent, trademark and copyright rights for U.S. nationals not less than the rights specified in these two conventions. China is not a member of the two conventions and is just in the midst of drafting their own highly complex patent and copyright laws. The result was a carefully written compromise which satisfies the basic needs of both parties. For example, with respect to patents, the two sides agreed that each party "shall seek, under its laws and with due regard to international practice, the ensure to legal or natural persons of the other party, protection of patents and trademarks equivalent to the patent and trademark protection correspondingly accorded to the other party".[21] As we shall see, China is, in both the patent and copyright fields, at work revising their basic laws and has already joined the World Intellectual Property Organization (WIPO). These steps can be viewed in part as positive indications of China's willingness to satisfy commitments made in the Trade Agreement and as a result of discussions with other foreign governments and private organizations.

III. INTELLECTUAL PROPERTY LAWS IN CHINA AFTER 1976

The present leadership of China seems prepared to make a rather dramatic turn away from Marxist ideology in their proposed new patent and copyright laws. The desire to upgrade China's scientific and technological capacity must be regarded as a fundamental factor. The unfamiliarity of Western technology owners with the Chinese method of protecting proprietary technology through contract has undoubtedly created situations where the most desirable technology has simply not been available to the Chinese. Another factor influencing the content of the proposed patent law in the PRC has been the frequent contact between the Chinese officials responsible for preparing the new patent law with patent officials from other nations. Finally, WIPO has clearly influenced the content of the Chinese patent law through the many discussions which have been held between Chinese officials and WIPO staff, through seminars conducted in the PRC by WIPO, and by the WIPO Model Law for Developing Countries on Inventions. In addition, WIPO encouragement to the PRC to adhere to the Paris Convention for the Protection of Industrial Property and to the Berne Convention for the Protection of Literary and Artistic Works has undoubtedly encouraged the Chinese to revise their trademark law and to adopt a copyright law.

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[21] U.S.-China Trade Agreement, Article VII.

Patent

Whatever the cause, it is clear that the Chinese have drafted and are considering the adoption of a rather conventional patent law. In addition, the Chinese Government has established, at least on paper, a Patent Office and are in the early stages of considering the construction of a building to house the patent operation.

Assuming that the present draft is adopted, the Chinese will have three different types of protection: a patent for inventions which will have a term of 15 to 17 years from filing; a patent for utility models which will have a term of 5 years from filing, with a possibility of an extension upon request for an additional 5 years; and a patent for industrial designs which will also have a term of 5 years from filing, with a possibility of an extension for 5 years upon request.

The latter two types of protection—the utility model patent and design patent—will be subjected to an examination for formalities only, while the patent for inventions will be subjected to a conventional substantive examination.

Of particular interest are the exclusions from patentable subject matter. The Chinese have stated several times that they intend to exclude the following areas from patent protection: chemical products (chemical processes will be patentable), animal species, plant species, foods, beverages, pharmaceutical products (again, processes will be patentable), computer software, and inventions relating to atomic energy.

The PRC will adopt a first-to-file system rather than a first-to-invent system as we have in the United States. This is not surprising since there are only three countries in the world which have a first-to-invent system.

The Chinese will also have substantive criteria for determining patentability which will be similar to the criteria used in most countries. Thus, in order for an invention to be patentable in the PRC, it must, be new or novel (this is to be defined as world-wide novelty), possess an inventive step, and have a practical application to industry or agriculture.

The Chinese will adopt a deferred examination system. Each application will be published 18 months after filing or, where applicable, 18 months after its priority date (an earlier foreign filing date to which the application is entitled) and the applicant will then be given another two years in which to request examination. If the applicant fails to request examination within 3½ years from filing, or again, where applicable, 3½ years after the priority date, the application will be abandoned.

There will also be an opposition procedure. In those cases where an application has been published and a request for examination has been made and also published, a member of the public will, from the later of these two events, have a period of six months in which to oppose the grant of a patent. Thus, an opposition could be initiated between 18 and 48 months from filing or, where applicable, from the priority date. If the application is abandoned prior to publication, or if the applicant fails to request examination, no opposition will be permitted.

An applicant dissatisfied with a decision of a patent examiner will have the opportunity to appeal that decision to a higher level of review within the Patent Office. If the applicant is dissatisfied with the decision coming from the review process, he may have his case reviewed in court. The Chinese are also thinking of permitting a member of the public who is unhappy with a decision of the Patent Office to issue a patent to have this decision reviewed in court.

Foreign patent applicants will be required to use a Chinese attorney or agent in matters before the Patent Office or before a court. The China Council for the Promotion of International Trade (CCPIT) is the organization to which a foreign inventor must turn to obtain an attorney or agent to represent him. This is similar to the Soviet system where foreign inventors must work through the Soviet Chamber of Commerce to file and prosecute patent applications. It appears that foreign inventors will be given a list of qualified attorneys or agents and will be able to select an attorney or agent of their choosing and to negotiate with him the terms and conditions of his representation.

Provisional protection will be accorded applications following publication. If an application is subsequently approved following examination, or any review process, a patent will be published and protection will be retroactive to the date of publication. One interesting twist is that the Chinese are currently contemplating requiring that a patent applicant refund any royalties paid to him while the application is pending in the Patent Office, if it is subsequently determined that a patent should not issue, or if the applicant abandons the application by failing to request examination.

The Chinese will adopt a system of maintenance fees which will begin after publication of the application, however, no decisions have been made concerning frequency or amounts.

With respect to the rights of patentees, foreign nationals and foreign enterprises who have received Chinese patents will have the right to enjoin others, including Chinese enterprises and socialist organizations, from making, using and selling their patented inventions and to obtain damages for unauthorized use. However, in those cases where the invention is determined to be very important to national defense, the economy, or public health, the patent owner's remedies will be limited to reasonable compensation. On the other hand, the Chinese will limit the patent rights of some domestic patent holders. Thus, Chinese socialist organizations will only be able to obtain royalties under their patents, and will not be granted injunctive rights. However, private enterprises (which would include joint ventures) and individual inventors who are not obligated to assign their inventions to their employers will be granted the full range of patent rights.

There are some similarities between the patent law of the Soviet Union and the anticipated patent law of the PRC. Both States restrict the rights of inventors employed by the State. The Soviet Union restricts protection for inventions made by such employed inventors to inventors' certificates.[22] The PRC, on the other hand, will grant patents for such inventions but will limit the patent rights to the ability to claim reasonable royalties. In addition, both limit the rights any inventor may obtain to certain important categories of inventions. The Soviet Union grants only inventors' certificates for chemical compounds; the PRC will not grant patents for chemical compounds, presumably limiting inventors to awards under the "Regulations on Rewards for Inventions" (discussed below).

The Chinese have indicated that they will follow certain principles of the Paris Convention for the Protection of Industrial Property. The two areas they have mentioned involve a reciprocal right of priority and a compulsory license for failure to work. The right of priority provision will be consistent with that specified in the Paris Convention, that is, foreign patent applicants will be able to obtain the benefit of their first filed application provided that they subsequently file an application in the PRC within twelve months. The working provisions of the Chinese law will provide for the grant of a compulsory license three years from the date of patent grant where the patent is not worked or is insufficiently worked. Importation will not satisfy the working requirement. The Chinese will permit patentees to argue that a compulsory license should not be issued because legitimate reasons exist for their failure to work their patents. Should a compulsory license be ordered, the licensee will pay reasonable royalties.

Regarding enforcement of patent rights in China, the Chinese appear to be thinking of imposing criminal sanctions for patent infringement. An infringer could be sentenced to imprisonment for up to two years. The Chinese also indicated that patent infringement disputes may be resolved through arbitration. The Chinese will publish a gazette which will contain bibliographic information for patent applications and patents, abstracts of inventions, the status of applications in the Patent Office, and various requests and notices such as those for examination, opposition, etc.

Rewards for Inventions and Technological Innovations

In addition to the new patent system, the Chinese are planning to continue to utilize an invention reward system. Thus, Chinese inventors may have the option to patent their inventions under the proposed new patent system or to seek awards for their inventions under the traditional inventor reward system. While there are certain similarities between the Soviet inventor's certificate system and the PRC's invention reward system, Chinese officials have stated on numerous occasions that they do not intend to utilize their system in the same manner as in the U.S.S.R.[23]

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[22] "Inventors" certificates are titles by virtue of which their holders have the right to compensation and other rights and privileges as provided in the national law of the country having granted them and by virtue of which the right to exploit the invention belongs to the State", [definition of inventor's certificate contained in document PR/DC/3, published by the World Intellectual Property Organization as part of a proposal for amending Article 1 of the Paris Convention for the Protection of Industrial Property].

[23] Under both systems, the reported inventions belong to the State and cash awards and certain honorary tributes are paid to the inventor. On the other hand, the criteria for determining whether to grant an inventor's certificate or an invention reward differ. The criteria for grant-

Continued

The "Regulations on Rewards for Inventions," released on December 8, 1978, basically revise and continue the regulations published in 1963. The criteria set down by the new regulations are almost identical to those used in determining patentability. They include "major new scientific and technological achievements" which have never been achieved previously, are more advanced that what is presently available, and prove through practice to be useful. Chinese nationals must submit inventions through the appropriate chain of command. Following review by the provincial, municipal, or autonomous regional scientific commissions, the inventions will ultimately be reported to and evaluated by the State Scientific and Technological Commission. Foreign nationals may report inventions directly to the State Scientific and Technological Commission.

There will be four classes of rewards for qualifying inventions, ranging from an invention certificate, a medal, and 1000 yuan at the bottom end of the scale to an invention certificate, a medal, and 10,000 yuan at the top. At current exchange rates, this amounts to $620 at the bottom and $6,200 at the top. While these awards are considerably smaller than the monetary rewards available in the 1950's, they are ten times the amounts that were contained in the 1963 regulations. Since rewards appear to have been little used since 1963, the contrast with the past is even more striking. While it is too soon to tell how the reward system will work in practice, the present Chinese system appears to reward Chinese inventors more liberally than is done in the Soviet Union.[24] Moreover, inventions of extraordinary importance will be given special rewards by the State Council (see the example in Section V). In a final exhortation, Article 14 states:

> * * * Those who hit at or suppress others trying to make inventions and who resort to deception regarding inventions or steal others' fruits of labor should be criticized, educated and rectified. Those involved in serious cases should be dealt with sternly or punished according to law.

We do not know whether the Chinese will ultimately prefer to utilize the patent or the inventor reward system for their patent-

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ing an inventors' certificate is the same as the more stringent criteria for issuing a patent; an inventor's certificate is disclosed and fully published, again, in the same manner as with a patent; and, and inventor's certificate gives rise to an exclusive right in the State to use, only recently limited to 15 years duration.

[24] The maximum Soviet reward for an invention is 20,000 rubles (or roughly $27,000 at current exchange rates) or about four times as great as the maximum Chinese payment of 10,000 yuan (about $6,200 at current exchange rates), but the lower awards (which are perhaps the more relevant ones for most Chinese inventions) are considerably higher in China (1,000 yuan or about $620) than the first three grades of the Soviet invention award system (the maximum payments for the first three grades in the Soviet system are: 20 rubles (about $27); 60 rubles (about $80) and 145 rubles (about $190). Since the average industrial wage in China is less than one fifth that of the Soviet Union, the incentive to invent should be much more powerful. For example, an average industrial worker in China would have to work 20 months to earn an amount equivalent to the minimum reward for inventions. The average Soviet worker, on the other hand, would earn an amount equivalent to the minimum initial award in less than half a week of normal work. To carry the analysis further, one would need detailed information on the actual awards paid for inventions (the number of awards, the average and modal reward for inventions and the number of awards made to individuals and to collective units) in both countries. No systematic information on this subject exists for China. For an initial empirical analysis of the way the Soviet system works in practice see John A. Martens and John P. Young, "Soviet Implementation of Domestic Inventions: First Results," in "Soviet Economy in a Time of Change," Joint Eonomic Committee, October 10, 1979, pp. 472-509. Martens and Young conclude that "a strong case can be made that the inventor's certificate today is less likely to be viewed as an afterthought" (p. 480) and that the Soviet R and D establishment is developing a "patent conciousness." Loc. cit.).

able inventions. There would appear to be advantages and disadvantages of both systems. Seeking an award under the inventor award system will probably continue to appeal to many Chinese organizations because of the system's familiarity, its relative simplicity and, perhaps, because it will not conjure up as much fear of benefiting from a rightist bourgeois practice. On the other hand, by assigning all rights in the invention to the State, Chinese organizations will lose the rights to future payments derived from use of the invention not only by Chinese enterprises but by foreign organizations as well.

"Regulations on Awards for Technical-Improvements" were also promulgated in 1963 and are still in force.[24a] Technical improvement awards are made if the improvements "lead to the achievement of more, faster, better and more economical results in production or work through experiment research and practical application." The awards vary from under 100 yuan for a technical improvement leading to a production increase of over 1,000 yuan and between 500 and 1,000 yuan for a production increase of over one million yuan. The monetary awards are accompanied by honorary awards and may be presented either to collectives or individuals.

Trademarks[24b]

The "Regulations Governing Trademarks" and the "Implementing Rules under the Regulations Governing Trademarks", both promulgated in 1963, remain in force. Reflecting perhaps a growing appreciation of some of the harsher features of both the Regulations and Rules as well as a desire to join the world community in trade matters, the Chinese have issued certain "notes". These notes have the effect of ameliorating the harsh effect of many of the regulations and rules with respect to foreign nationals seeking trademark protection in the PRC.

Trademarks in China are similar to trademarks in most Western nations in that they represent a certain level and consistency of quality of the goods on which the marks are used. As previously noted, however, there is a difference in that the Chinese trademark regulations are almost exclusively concerned with the trademark function of representing a certain level of quality. There is little or no concern for the more traditional trademark functions of identifying goods as those of a particular manufacturer or distinguishing the goods of one manufacturer from another. The preoccupation with quality is exemplified by the requirement that Chinese enterprises applying for registration of a trademark file a "quality specification form" for the goods with which the trademark will be used. This quality specification form is to be completed according to "prescribed technical criteria for the products" and is examined and certified by competent authorities.

[24a] New regulations governing "rewards for rationalization proposals and technical renovations" were announced after this article was completed [Xinhua, "Regulations Issued on Rewards for Improvements", *FBIS-CHI* April 13, 1982, pp. k-11—k-13]. The primary effect of the new regulations will be to increase the incentive for making a successful proposal. Proposals found to have an "annual economic return" in excess of 1 million yuan will be rewarded by cash awards from 1,000 to 2,000 yuan. This award is twice as high as in the 1963 regulations. Similar increases in cash awards are also given for successful proposals with "annual economic returns" less than 1 million yuan. Although these regulations were only published in April 1982, they probably were in effect at least one year earlier. This would explain the inconsistency noted below in footnote 34.

[24b] Well after this paper was completed, the Chinese promulgated its new trademark law on August 25, 1982. It will become effective March 1, 1983. Among the most interesting provisions of the new law are: (1) a system of civil remedies for trademark infringement and (2) provision of a system of licensing of the rights to use trademarks in China. The new law has been analyzed in Charles Golz's "China's New Trademark Law," *China Law Reporter*, Vol. 2, Summer 1982, issue No. 2.

The preoccupation with quality is further evidenced by Article 11 of the Regulations which specifies that the Central Administrative Bureau for Industry and Commerce may cancel a registration where "the quality of the goods concerned is lowered through roughness or carelessness in manufacture." While the quality specification form is not required for foreign enterprises, they are subject to Article 11 and, therefore, may have their registrations cancelled if they lower the quality of the goods on which their marks are used.

A trademark may be any distinctive sign. However, certain words and designs are prohibited from use as trademarks or in trademarks. These include: marks identical with or similar to the national flag, national emblem, military flag or decoration of the PRC or foreign countries; marks identical with or similar to the emblems or names of the Red Cross or the Red Crescent; and, marks having a politically undesirable influence.

While Chinese enterprises are not permitted to use foreign words in trademarks, the "notes" exempt foreign enterprises from this prohibition.

Trademark rights are created through filing and registration and not through use. Where two or more enterprises apply for the registration of identical or similar marks, the first applicant shall be accorded the registration. Service marks are not mentioned in the Chinese trademark regulations.

The test for registration is similar to the test prescribed in U.S. law (15 U.S.C. 1052(a)), namely, a trademark may not be identical with or confusingly similar to any trademark already registered in the name of another enterprise for the same or similar goods. If a trademark is approved for registration, the registration is published and a certificate of registration issued. There is no opposition period as exists under 15 U.S.C. 1063. The "notes" provide that the term of a trademark registration for foreign enterprises is 10 years, with 10 year renewal terms available. For the non-exempted Chinese enterprises, however, the regulations provide that the term of a Trademark registration is indefinite, ending when the enterprise concerned applies for its cancellation. Of course, the registration may be cancelled for other reasons.

If an application for the registration of a trademark is rejected by the Trademark Registration Agency, the applicant may request a reexamination within one month of the date he receives the rejection notice. A second refusal is final and conclusive. The Chinese are considering incorporating into their law a procedure for court review of a final agency refusal to register a mark.

In addition to the possibility of a trademark registration being cancelled due to the lowering of the quality of the goods, a trademark may also be cancelled, where the name and/or design of the mark are altered by the enterprise, or where, after examination, cancellation is deemed well-founded and justified in light of the demands and proposals raised by masses of people, government organs, public associations or enterprises.

Presumably this last reason for cancellation is a catchall which gives the government rather broad powers to move against an enterprise which has fallen from favor for whatever reason. The Chinese have indicated that, should this provision be invoked, the trademark owner would have the right to present arguments to the authorities concerned, emphasizing that cancellation would only occur if there were very good reasons and that it would not be arbitrary.

Chinese enterprises may also have their marks cancelled on the basis of non-use for one year without approval of the competent authorities. The "notes" preclude application of this provision to foreign enterprises. According to the "notes", a trademark of a foreign enterprise which has not been used for one year shall not be cancelled and shall continue to be effective. In fact, there is no limit stated with respect to non-use of marks of foreign enterprises.

Two significant conditions precedent to registration of trademarks in the People's Republic of China had been stated in Article 12 of the Regulations. First, there has to be an agreement providing for reciprocal registration of marks between the PRC and the home country of the applicant; and second, the mark for which registration was sought in the PRC has to have been registered by the applicant in his home country.

In 1977, the Chinese made a decision which obviated any problems created by these two conditions. According to that decision, the question of reciprocal trademark protection and the question of whether a copy of a home registration need be filed would, beginning January 1, 1978, be answered on the basis of reciprocity, irrespective of whether a formal agreement existed. In other words, if a Chinese enterprise could apply to register its mark in a particular foreign country without first having had to register its mark in China, then a firm in that country could likewise apply to register its mark in China without having first had to register its mark domestically.

The China Council for the Promotion of International Trade has been entrusted with the task of securing trademark registrations for foreign enterprises, similar to its responsibilities in the field of patents. Separate applications are required for the registration of an identical mark for goods in different classes. There are some 78 classes in the Chinese classification scheme.

The application fee of 20 yuan (approximatey $12) will be refunded if the application is rejected. If the application is accepted, there is an agency fee charged by the CCPIT of 230 yuan (approximately $140). Thus, a successful trademark applicant will pay fees in the neighborhood of 230 yuan.

Trademark registrants may also file applications to alter their marks, to replace damaged or lost certificates of registration, to renew registrations (which must be prior to the expiration), and to assign their marks. In addition, a trademark registrant must secure the approval of the competent authorities before using his mark for other goods in the same class. The fees for renewal applications, renewal registrations, and agency fees are identical to those associated with original applications.

An application to register a trademark must be filed in duplicate and must be accompaned by a power of attorney in duplicate, a certificate of nationality, and twelve prints of the mark involved. The original copy of the power of attorney and the certificate of nationality must be authenticated.

Copyrights

Hsia and Haun state that "The People's Republic of China is not known to have enacted a comprehensive statute on the copyright." Unfortunately, this statement remains accurate. There are, however, certain hopeful signs that the situation may be changing.

Article 6 of the Agreement on Trade Relations Between the United States of America and the People's Republic of China provides some incentives in this area. Paragraph 1 of Article 6 states that both contracting parties recognize the importance of effective protection of coyrights. Paragraph 5 of that same article then sets forth the obligations of each side:

> Both Contracting Parties agree that each Party shall take appropriate measures, under its laws and regulations and with due regard to international practice, to ensure to legal or natural persons of the other Party protection of coyrights equivalent to the copyright protection correspondingly accorded by the other Party.

One month after the signing of the Trade Agreement, Mr. Chen Hanbo, Director of the Publisher's Association of China, indicated that Chinese authorities would present a domestic copyright law to the National People's Congress "as soon as possible." Mr. Wang Heng, who is with the National Publishing Administraton of China and who is perhaps China's leading copyright expert, has stated that a ten person copyright study group had been established in Beijing to draft a copyright law. Provincial study groups have been established to work with the Beijing group and each publishing house also has at least one person to follow copyright matters. The Chinese believe that this effort responds to and places China in full compliance with the intent of Paragraph 5 of Article 6 of the Trade Agreement.

According to Mr. Wang, copyright protection in China will extend to more than just literary works. Copyright protection will be available for pictures, art, and other works, although the Chinese remain undecided on the exact spectrum of works they will copyright. The Chinese copyright law, which will be included in the civil code, will recognize and protect moral and economic rights, as well as provide adequate protection to authors. The Chinese will probably adopt some form of registration system. In accordance with their custom, it appears the Chinese are thinking of paying royalties on the basis on the length of work rather than on the number of copies distributed. Mr. Wang has stated that due regard will be given to international practice during the drafting of the copyright law and that the PRC currently plans for its copyright law to at least satisfy the Uniform Copyright Convention, to which they will adhere "when the conditions are right."

Regarding the timing of the adoption of a copyright law by the Chinese, it has been indicated that a certain amount of promotional work on the concept of copyright must be conducted first. As has been indicated earlier, there is a certain tension between the concept of copyright and the Chinese communist ideology. However, recent expressions of interest by Chinese officials in obtaining copies of typical licensing contracts between Western parties may portend increasing interest arising from the anticipation of hard currency from the sale and distribution of translations of Chinese works. At this time, however, it is not possible to go beyond the simple conclusion that the Chinese are in the process of drafting a copyright law.

IV. UNCERTAINTIES AND PROBLEMS ARISING FROM CHINA'S INTELLECTUAL PROPERTY LAWS

The first and perhaps most difficult problem to assess is the depth of the Chinese commitment to the timely introduction of new patent and copyright laws. In both cases, Chinese leaders have made statements on numerous occasions about their commitment to introducing patent and copyright protection.[25] As we have stated above, a detailed draft of the patent law exists and a sizeable staff has been at work preparing for the installation of a new system.

Nevertheless, it is clear that there is domestic opposition to the new patent law and undoubtedly to the proposed copyright law as well. Foreign delegations have been formally and informally apprised of the fact that the proponents of patent legislation have not yet succeeded in gaining approval from all the important elements of the Chinese decision-making process. A number of officials in the industrial ministries feel the adoption of a patent law will reduce their access to foreign technology because they will be unable to pay for the technology they desire and they will be prohibited from copying. Other Chinese leaders are undoubtedly arguing that the patent laws may have the effect of restricting the free flow of technology within China. Finally, many Chinese leaders—including many who would not consider themselves in the radical group—are likely to be concerned about the income differentials and unsocialist behavior which may arise under the new system.

We have no way of knowing how serious the opposition is. But it is clear that it exists and that it has already delayed the implementation of the new laws. At the very least, we must caution that domestic opposition within China may still affect the final character and the timing of the promulgation of the patent and copyright laws.

We recognize that it is even possible that political changes in China and a further mushrooming of domestic opposition could conceivably endanger passage of these laws. Nevertheless, barring major political upheavals or a drastic re-assessment of the present foreign policy course of the Chinese government, we are inclined to believe that the main impact of the opposition to intellectual property protection will continue to delay and to modify the ultimate legislation—but will not prevent the passage of the kind of laws outlined above.

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[25] As recently as July 1981, China's commitment to establishing a patent system was reaffirmed by Vice Premier Fang Yi when he met with a delegation from the Japan Patent Association. FBIS-CHI July 9, 1981, p. D-1.

The authors are also reluctant to analyze the detailed problems which Chinese intellectual property laws will pose for Western businesses. Particularly in the trademark field, considerable experience has been gained by trademark counsel representing numerous firms. It would be presumptuous of the authors to suggest that they have had any practical experience in dealing with the problems that have confronted lawyers and business people when protecting their rights in the PRC. Nevertheless, a modest effort will be made to identify the problems which appear to exist, with the hope that others will correct and supplement the comments which follow.

Patents

Of course, the fundamental problem facing Western industry seeking to protect its new technology in the PRC is simply that the Chinese do not yet have a patent law. Accordingly, Western firms are forced to continue to rely upon provisions in contracts to protect their technology. Since the ability of a particular firm to protect their technology by a contract varies from situation to situation, the prospects are good that some businessman will continue to face frustration and disappointment and that the Chinese will continue to obtain some outmoded technology.

Little is known regarding some of the important details concerning the patent system which the Chinese will establish. Questions such as the type of claim practice which will be adopted, the prior art against which patentability will be determined, the length of time one can expect the patent process to take, etc., must necessarily await the publication of the Chinese patent law and regulations. However, the general outline of the proposed patent system is known and at least some problems can be anticipated.

Foremost among the likely obstacles which Western firms will face in the PRC is the lack of patent protection for chemical compounds and pharmaceuticals. The officials responsible for designing the Chinese patent law have concluded that China should not initially protect chemical compounds and pharmaceuticals. Their decision seems to be based primarily on the absence of protection for such products in developing countries. The Chinese argue that their industry is at the same level of development as many other countries which do not protect chemical compounds and pharmaceuticals. They argue, therefore, that they should not protect such products. While they acknowledge that the world trend is towards increased protection for chemical products and pharmaceuticals, they argue that even a highly developed country like the Federal Republic of Germany only moved to protect chemical compounds within the last fifteen years. Therefore, they conclude that China need be in no rush to offer patent protection in such areas. Following the examples set by the countries after whom the Chinese are modeling their patent law, however, they have indicated that patent protection will be available for chemical and pharmaceutical processes.

This decision by the Chinese will obviously have adverse consequences for American chemical and pharmaceutical firms. Moreover, this decision also may not be in China's own best interest.

Considering the research and developments costs associated with both pharmaceuticals and agricultural chemicals, many foreign companies will not spend significant resources developing products for Chinese conditions.

Plants are also expected to be excluded from patent protection. This is somewhat surprising since one of the areas in which the Chinese have actually sold "technology" to the West involved a plant variety, specifically, a new type of rice. Moreover, it would seem that the Chinese would want to create maximum incentives for the development of a more productive agricultural sector.

In addition, some important industrialized countries extend protection of plant varieties to foreign nationals on the basis of reciprocity, e.g. the foreign national can protect only those varieties which his country protects. Thus, the Chinese could find that their exclusion of plant varieties from patent coverage might well make it more difficult for them to patent and sell agricultural technology in world markets. Of course, Western breeders will be unenthusiastic about investing resources to develop new crops and other food sources tailored specifically to Chinese needs without the prospect of a reasonable return on their investment which the patent system would offer.

Several questions arise regarding the enforceability of patent rights in the PRC. First, one must ask, given the closed nature of the Chinese society, how could a firm determine whether its patents were being respected in China. For example, how would Western firm know whether its patent, licensed for use in a single plant in the Shanghai area, was also being used in similar plants in the far reaches of the PRC? While export products might provide evidence of patent infringement, products intended solely for domestic consumption and patented processes present much more difficult considerations.

Another potentially troublesome area involves how the government would determine which patents it will exploit for national defense and other purposes. Closely linked is the question of how compensation for such governmental use would be determined. The Chinese currently plan to limit a patent owner's remedies to reasonable compensation in areas important to national defense, the economy, and the public health. In a socialist country, a governmental right to use, for "reasonable compensation", any invention relating to the "economy" could all but vitiate the value of a patent. Some additional guidance regarding the scope of these governmental powers will be necessary before Western businessmen can determine the real value of a patent in the PRC.

Similarly, assuming that the PRC places reasonable limits on its right of eminent domain in the patent field, the question of how "reasonable compensation" is to be calculated is also of fundamental importance, Does "reasonable compensation" have the same meaning in the PRC as it would have in a Western economy? Will the Chinese provide a right of review for a patent owner dissatisfied with the level of compensation established? These and many other questions concerning compensation need to be known before Western firms can intelligently determine the desirability of seeking patent protection in the PRC.

The Chinese have indicated that their patent law will contain a working requirement which will be compatible with that provided in the Paris Convention. Assuming that the Stockholm Act of the Paris Convention continues to remain in force for at least the immediate future, this means that the Chinese will provide a compulsory license to practice any invention which the owner fails to work, either four years from filing or three years from grant, whichever is later. The Chinese have also indicated that the patent owner will be permitted to argue, as mandated by the Convention, that a compulsory license should not be issued because the owner has been unable, for legitimate reasons, to work the patent. Should a compulsory license be granted, the Chinese indicate that the patent owner will be paid reasonable royalties. Numerous questions arise. Assume a patentee wishes to commence working his patent at an early date. How difficult will the Chinese make this for the patentee? Will he be able to obtain the necessary approvals, or find a partner in a joint venture, to commence such working within the statutory time frame? If the patentee is precluded from working due to his inability to obtain the needed governmental approvals, will this be considered a legitimate reason by the Chinese authorities for failure to work? Again the question of determining the level of reasonable compensation must be considered. Additionally, will the decision granting the compulsory license be reviewable?

In summary, there are many questions facing Western businessmen interested in obtaining a patent in the PRC. Unfortunately, most of these questions cannot be answered until the details of the Chinese patent law are available. Indeed, many specific questions cannot even be intelligently raised until that time.

Trademarks

The laws regulating trademarks in the People's Republic of China is obviously more settled than with either patents or copyrights since trademark "Regulations" and "Rules" have been in force since 1963. Also, as previously noted, the Trade Mark Registration Agency has issued certain "Notes" which exempt foreign applicants from certain aspects of the Regulations and Rules. By November 1980, U.S. nationals had filed over 2,000 trademark applications in the PRC, from which over 300 registrations were issued to nearly 100 U.S. firms.

Initially, it is noted that only trademarks can be registered under the PRC "Regulations". Not only does there appear to be no means available for the registration of service marks, but there seems to be no protection of any kind for such marks. The absence of protection for service marks in the PRC should be an important consideration to the increasingly service oriented Western economies.

The absence of any protection for service marks also raises a question about the PRC's plans to ratify the Paris Convention. For example, Article 6 of the Convention requires member countries of the Paris Union to protect service marks, although they do not have to provide for the registration of such marks. There are other requirements involving the protection of trademarks where the existing PRC trademark law appears deficient. For example, the PRC trademark law does not provide for granting a right of priority with respect to a trademark application as required by article 4(A) of the Convention; it does not provide for the registration of collective marks as required by Article 7*bis* of the Convention; and, it does not provide for the protection of trade names as required by Article 8 of the Convention. In addition, the authors are not aware of any provisions in Chinese law which would provide protection against unfair competition as required by Article 10*bis* of the Convention. These are a few of the several inconsistencies which exist between the requirements of the Paris Convention and the provisions of the PRC law. While those Chinese Government officials responsible for drafting the patent law have suggested that the PRC will adhere to the Paris Convention, it is not altogether clear whether their views are shared by the officials responsible for administering the trademark laws. Clearly, some amendments to the PRC trademark laws and the creation of certain other laws such as one for the repression of unfair competition appear necessary before adherence to the Paris Convention could occur.

Although the basic criteria for determining registration, e.g., that the mark not be identical with or confusingly similar to a mark already registered by another for the same or similar goods, is fairly standard, the law also states that marks having a politically undesirable influence may not be used as trademarks. Unfortunately (or perhaps fortunately), no guidance is given as to what constitutes a politically undesirable influence. Undoubtedly some unsuspecting Western merchant will some day learn what falls in this category when his trademarked goods are denied entry or registration of his mark is denied.

Another area of potential concern to trademark applicants is the lack of any court review of a refusal by the Trade Mark Registration Agency to register a mark. Article 8 of the Regulations appears to give a trademark applicant the right to obtain an initial evaluation of the registrability of his mark and the right to request a reexamination within one month from the date registration of his mark was denied. Again, only through the accumulation of practical experience can the absence of court review be properly evaluated.

Another interesting problem is that there are no provisions in the 1963 PRC trademark law giving a registrant the right to prevent another from infringing his mark. Hsia and Haun point out that the 1950 Provisional Regulations Governing the Registration of Trademarks provided an exclusive right to one's trademark, a right enforceable against the infringer in a local People's court. The authors do not know why these rights were dropped nor what a trademark proprietor can or should do to protect his mark.

One could, perhaps, construct an argument on the basis of Article 2 of the Regulations that a trademark owner does have a right to prevent infringement of his registered mark in the PRC. Since Article 2 requires that an application for registration be filed for all marks used in the PRC, it could be reasoned that Article 2 impliedly requires that no mark may be used without a registration. On the basis of such reasoning, a firm finding its mark infringed in the PRC might approach the Trade Mark Registration Agency to point out that an unregistered mark was being used contrary to Article 2 of the Regulations and request the Agency to take appropriate action. Alternatively, the trademark owner might file an action in the People's Court asking that the use of the mark by the accused infringer be stopped until he registers the mark in the PRC. Hopefully, such registration by the accused infringer would be blocked by Article 6 of the Regulations (confusing similarity). Admittedly, this is reaching.

A potential problem for Western trademark proprietors may lie in the absence of any means by which they can oppose a mark registered by another. Without the opportunity to oppose (as exists under section 13 of the Lanham Act), it is conceivable that a trademark proprietor may find his mark already registered in the PRC at the time he contemplates developing a market for his goods. Moreover, the fact that the "Notes" issued by the Trade Mark Registration Agency exempt foreign trademark owners from the provision for cancellation on the basis of one year's non-use exacerbates the problem. An unscrupulous individual could register even a well-known Western mark prior to the registration of that mark by the proprietor and, since the registration could not be cancelled on the basis of non-use, exact a bandit's price from the trademark owner for the privilege of registering his mark.

Article 11 of the regulations could also create problems for Western firms. This Article provides that the Central Administration Bureau for Industry and Commerce shall give public notice of cancellation when cancellation is deemed well-founded and justified in light of the demands and proposals raised by masses of people, government organizations, public associations or enterprises. No explanation is available as to the circumstances which must exist before cancellation of a registered mark will be "deemed well-founded and justified in light of the demands and proposals raised by masses of people, government organizations, public associations or enterprises." As previously mentioned, this reason for cancellation is presumably a catch-all which gives the PRC Government broad discretion to move against any enterprise which has fallen from favor for whatever reason. Although not required by the Regulations or Rules, the Chinese have stated that, should this provision be invoked, the trademark owner would have the opportunity to argue against cancellation of his registration. The Chinese authorities have also stated that cancellations would only occur if very good reasons existed and that their actions would not be arbitrary.

It may be that Article 11 could be used by a firm as a means to oppose a mark which it believes was improperly registered. Thus, the firm might argue to the Central Administrative Bureau for Industry and Commerce that cancellation of the registration of a mark would be well founded under subparagraph (4) of Article 11 since the mark was identical with or confusingly similar to a mark previously used and registered in other countries throughout the world by the petitioning firm. It might also be appropriate to first attempt to convince the China Council for the Promotion of International Trade to raise this argument since the CCPIT would be a "government organ" which can make such a demand under the language of Article 11.

Copyrights

Practically nothing is known of the specifics of the copyright law which the PRC will develop and, therefore, it is of little value to speculate about what problems foreign authors and publishers might face in protecting their works in the PRC. There have been complaints from both foreign nationals about the copying in the PRC of works protected outside the PRC as well as complaints by the PRC about the copying in various other countries of Chinese works. Hopefully, the mutual interests of all concerned will lead to a prompt enactment of a copyright law by the Chinese.

V. CHINA'S RECENT INTELLECTUAL PROPERTY PROTECTION PRACTICES

Previous sections have emphasized that China has recently promulgated new regulations with substantially higher monetary rewards for inventors and are far advanced in drafting new patent legislation. Moreover, the nucleus of a patent office has been created and already numbers about 100 trained individuals. Trademark legislation is being modernized and consideration is being given to copyright legislation.

A further indication of the seriousness of Chinese intentions is the fact that even before the legislation has been completed, planners already have begun to utilize new forms of rewarding inventors and have provided a measure of protection to industrial property holders. In addition, product differentiation as a means of stimulating competition among Chinese enterprises has been encouraged. In typical Chinese style, the planners are experimenting with provisional systems even before publishing the final legislation. This section will describe some recent reports on China's evolving practices in these areas.

The general problem for Chinese planners is to construct a system which stimulates competition among individuals and enterprises and provides substantial rewards to inventors and innovators without stifling the free exchange of technical information across administrative and bureaucratic boundaries. Vice Premier Yao Yilin's 1980 Economic Report indicated that the problem had been recognized and was being given high level attention: "While promoting competition, the socialist spirit of cooperation and exchange of technical know-how should be encouraged. A royalty scheme will be worked out to govern important new technologies."[26]

According to one report, a royalty system has been in use since September 1979 at the Physics Institute of the Chinese Academy of Sciences. Researchers were reportedly delighted that factories were finally becoming interested in the results of new research. As a result, the factories no longer produced "the same old stuff year after year" and the scientists "no longer have to desperately peddle their research results".[27] In one year, the institute signed contracts with 19 factories covering 21 of its research results. The research institute was reimbursed either by a lump sum or by a share of the profits or gross proceeds. However, it is not clear if the recipients were committed to keeping the technologies secret.

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[26] Yao-Yilin, "Economic Report at August 30, National People's Congress", FBIS-CHI September 23, 1980, p. 14.

[27] Xinhua, "Factories Apply New Technology in Production", September 19, 1980, p. L-26.

The right of enterprises to maintain technical secrets was defended in a February 1981 article by a Shanghai writer who straightforwardly admitted that there is a "phenomenon of keeping of technical secrets in the course of technical exchanges and cooperation in Shanghai's industry, science and technology system."[28] The writer argued that "since there is competition, it will necessitate the keeping of technical secrets. A recognition of the right of enterprises to protect their new techniques is a necessary condition for developing and protecting socialist competition. If we still maintain the situation of 'eating out of the same pot' in technical development, it will only encourage those lazybones who sit idle and enjoy the fruits of others' work."[29]

It is doubtful that national leaders will allow technically advanced areas or enterprises to monopolize advanced technology or veto transfers to less advantaged parts of China. Nevertheless, completely free exchange of technologies from one part of China to another may be a thing of the past. Local organizations in Shanghai have already drafted a document entitled 'Experimental Regulations on Protection of Technology and Transference of (?Technology) (sic) in Shanghai".[30] Less well endowed regions of China such as Hubei province have had to educate the comrades "not to put any more burden on them when asking for help from Shanghai's departments and enterprises."[31] The same report endorsed the principle of paying for technology acquired from Shanghai: ". . . in these two years, according to different situations and with the approval of certain leading departments in Shanghai, we have adopted various measures, such as sending out to learn and inviting in to teach, establishing direct contact and learning from related units, signing contracts in joint management, exchanging technology and paying in installments."[32]

To date, there is little evidence on how China will implement the 1978 reward system for inventors. Nevertheless, it appears from the publicity already accorded to successful inventions that China's leaders are planning to use both honorific ceremonies and monetary rewards much more vigorously than in the past. For example, in March, 1981, the Ministry of Light Industry held a ceremony that awarded a certificate of merit and bonuses to people "who had invented or improved on high-quality industrial goods and advanced production techniques."[33] At that ceremony, three Chinese organizations (one research institute and two factories) received "first class awards" and bonuses of 2,000 yuan. An additional 669 monetary bonuses that ranged from 300 yuan to 1,000 yuan were paid to other units under the Ministry of Light Industry.[34] Moreover, the new system for special rewards for "inventions of extraordinary importance"[35] has already been utilized in at least one instance. In June, 1981, Fang Yi, Vice Premier and Minister in Charge of the State Science and Technology Commission, presented the first special award worth 100,000 yuan to the leader of a team of agronomists that developed a new hybrid rice strain.[36]

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[28] Xu Guoquan, ibid., p. O-2.

[29] Loc. cit.

[30] "Shanghai Conference on Science and Technology Closes" Shanghai City Service in Mandarin, May 26, 1981, in FBIS-CHI, May 28, 1981, p. O-6. The report merely cites the name of this draft regulation and does not give any details about its content.

[31] Chen Pixian, "Transplant Shanghai's Advanced Experience: Develop the Role of Existing Enterprises", People's Daily, May 28, 1981, p. 2, in FBIS-CHI, June 9, 1981, p. K-8.

[32] Loc. cit.

[33] "Light Industry Ministry Awards Indsutrial Inventors", Xinhua in English, March 7, 1981, in FBIS-CHI, March 12, 1981, L-18.

China's practices vis-a-vis trademarks may be changing as well. The current emphasis on inter-enterprise competition has led to placing more emphasis on brand name identification. Last November, China held a national meeting to issue certificates to "famous trademarks". At this meeting a leading official made the following statement:[37]

> China is encouraging enterprises to compete under the guidance of the national plan. To protect trademarks is one of the important measures adopted to protect competition. Imitation or counterfeit of a registered trademark, will be punished by law.

In addition to guaranteeing quality, the role of trademarks has been expanded so that enterprises now are encouraged to gain consumer recognition of their products. In early 1981, a People's Daily editorial on consumer goods production endorsed brand name identification of prominent consumer goods: "concentrated efforts (should be made) to develop name-brand products, for example, the Fenghuang, Jongjiu, Feige and other name brand bicycles and the often mentioned three big items (bicycles, sewing machines and wristwatches) or five big items (the three big items plus radio receivers and television sets)."[38]

The stress on encouraging competition and identifying products by brand names has emerged at the same time that advertising has reappeared in China. Now, Chinese factories vigorously advertise their products in newspapers, magazines, billboards as well as on radio and TV. While "cut throat" competition is still a long way off in China, the managers and workers of many marginal enterprises have been hard pressed to remain in business. This has led to some aggressive advertising practices by some units. In some cases, the Chinese press has lauded the positive results of advertising:[39]

> A chemical factory producing articles of daily use in far off Qinghai has produced a kind of paste against the common cold which has been appraised to be of a quality up to advanced national levels and remarkably effective. However, it was not selling well because nobody heard of it. Later, after advertising in the papers, orders

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[34] The report stated that awards were made to "people who had invented or improved on high quality light industrial goods and advanced production techniques." (Ibid. p. 18). The report did not distinguish between awards for inventions and technical improvements. The awards mentioned in the report are somewhat inconsistent with the regulations on the reward systems. The highest awards reported in the article were three "first class awards and bonuses of 2,000 yuan". The 1963 Regulations on Awards for Technical Improvement carry a maximum (first class) bonus of only 1,000 yuan. On the other hand, a 1,000 yuan award under the 1978 inventor reward system is only a class three award. Both Regulations have been reprinted in Annex 7 of E. P. White (Ed.), "USA and China: Technology and Patents Sale and License". The report is available from Licensing Executives Society, P.O. Box 1333, Stamford, Connecticut 06904.

[35] See Section III, p. 19.

[36] Xinhua, "Fang Yi, Other Leaders Attend Science Conference", FBIS-CHI, June 8, 1981, p. K-5.

[37] Xinhua, "Yao Yilin Attends Meeting on Trademarks", FBIS-CHI, November 4, 1980, p. L-1.

[38] People's Daily Editorial, "Place Consumer Goods Production in an Important Position", FBIS-CHI, March 31, 1981, p. L-9.

[39] People's Daily Commentator, "Truth is the Life of Advertising", FBIS-CHI, February 6, 1981, p. L-15.

poured in from all parts of the country. So, the saying "an advertisement has saved a factory" is not an exaggeration.

On the other hand, abuses of advertising practices have also been reported. One enterprise began to advertise its product before its plant had been completed. People's Daily condemned another plant that claimed a "major scientific achievement" as "sheer lying" and went on to warn that "if an enterprise does not prize its reputation but, to meet temporary needs, irresponsibly puts out exaggerating advertisements to deceive others, it is tantamount to drinking poison to quench a thirst." [40]

VI. CONCLUSION

The Chinese are in the midst of a major rethinking of the manner in which they can encourage creativity for economic application. It is clear that the new policies have high level support and that important new legislation has been drafted. Laws providing Patent protection for inventors is said to be nearly complete. Moreover, the Chinese are already experimenting with providing more material incentives and a certain amount of control over the use of successful new inventions.

It must be emphasized, however, that a great deal remains uncertain. The new programs have been opposed by some influential Chinese organizations. We do not know if the opposition will simply retard and modify the new legislation or whether the opposition endangers the basic thrust of the new policies. We suspect the former judgement is correct, but we cannot be certain.

Even if new laws and policies regarding patent, trademark, and copyright protection are successfully introduced in the near future, major questions will still remain. First, how easily can these reforms be reconciled with an economic system that will, for the forseeable future, remain strongly planned and centralized? Secondly, how far will Chinese communist party leaders be willing to go in the direction of allowing a new scientific elite to gain not only much higher incomes but also a degree of control over the distribution of the results of their endeavors? Such questions, of course, are not unique to intellectual property policies. They reflect the larger problems Chinese leaders face in attempting to graft some market forces and effective incentive systems onto a basically collectivist and centrally planned economy.

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[40] Loc. cit.

UNFROZEN ASSETS: THE 1979 CLAIMS SETTLEMENT BETWEEN THE UNITED STATES AND CHINA

By Natalie G. Lichtenstein*

On that cold March morning in 1979, the public waiting room of the Beijing Airport may have seemed an unlikely place for Chinese and American officials to signal agreement on unfreezing the so-called "frozen assets,"[1] but the timing came as no surprise. Two months earlier, the United States had finally recognized the People's Republic of China (PRC) as the sole legal government of China.[2] The day before, the U.S. representative, then Treasury Secretary W. Michael Blumenthal, had presided over the official metamorphosis of the U.S. Liaison Office into the first U.S. Embassy in Beijing in 29 years.[3] As the political winds shifted, the claims/assets issue had once again proved an accurate barometer of the climate of Sino-U.S. relations: Sino-U.S. confrontation in Korea in 1950 led to the blocking of Chinese-owned assets in the U.S. and the subsequent seizure of American-owned property in China; the Sino-U.S. thaw in 1971 saw some relaxation of U.S. restrictions on trade with China; and finally, Sino-U.S. normalization on January 1, 1979 had brought with it the resolution of this long-standing property dispute.

If the timing of the settlement was heavily influenced by political concerns, neither the settlement nor the problem it resolved was lacking in economic or financial impact. What follows is a detailed review of the historical development of the problem, the issues for resolution, the terms of the settlement, and the course of its implementation.

When the PRC was established on October 1, 1949, after decades of civil war between the successful Chinese Communist forces and the Kuomintang (Nationalist) forces which retreated to the island of Taiwan, the path of future relations with the U.S. was not yet indelibly marked. While the United States had supported the Nationalists, there were certainly those in America who believed that the question of which Chinese government to recognize would be answered in time by a final defeat of the Nationalists at the hands of the Communists.[4] Statements made by U.S. officials early in 1950 suggest that the U.S. position on the China/Taiwan question still left room for some flexibility.[5] Nevertheless, whatever nascent flexibility there may have been in U.S. treatment of the Chinese Communist government was effectively ended by the U.S. entry into the Korean War in June 1950. Along with the North Koreans and the Russians, the Chinese became the enemy. It was in this context that the U.S. government reacted to the entry of PRC forces into the Korean War.[6]

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This article is an expanded and updated version of an earlier article by the author which appeared at 1 China Law Reporter 25 (1980).

[1] Solomon, "When 41¢ on the dollar is a good deal," The Christian Science Monitor, Mar. 28, 1979, at 23.

[2] Joint Communique on the Establishment of Diplomatic Relations between the United States of America and the People's Republic of China, Jan. 1, 1979, in N.Y. Times, Dec. 16, 1978, at A8, col. 3.

[3] N.Y. Times, Mar. 2, 1979, at A1, col. 1.

Chinese Assets

On December 16, 1950, President Truman declared a national emergency based on "recent events in Korea and elsewhere."[7] The next day, December 17, 1950, the Secretary of the Treasury issued the Foreign Assets Control Regulations (the Regulations), which not only enforced a complete embargo on commercial and financial transactions with the PRC, North Korea and their nationals, but also blocked all Chinese and North Korean property in the U.S.[8] And so it was that the U.S. government required property holders to create a new phenomenon: frozen Chinese assets.

It is important to note at the very outset that the freeze was extraordinarily broad in its scope. Blocked properties were defined as those "in which any designated foreign country, or any national thereof, has at any time on or since the effective date . . . had any interest of any nature whatsoever, direct or indirect." [9] The specified prohibited transactions were those involving blocked property or undertaken "by, or on behalf of, or pursuant to the direction of any designated foreign country or nationals thereof." [10] China was designated as a foreign country subject to these restrictions as of 12:01 a.m., Eastern standard time, December 17, 1950.[11] Consequently, the frozen Chinese assets not only included property actually owned by the PRC or PRC nationals, but also included property which was actually owned by others, and in which a mere indirect interest of the PRC or a PRC national existed. It is this broader meaning which must be assigned to the term "frozen Chinese assets" in the pages which follow.

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[4] For example, an interdepartmental conclusion was reached among the Army, Navy, Air Force and State Departments on October 12, 1949, that Taiwan would be under Communist control by the end of 1950. "Military Situation in the Far East: Hearings before the Senate Committee on Armed Services and the Senate Committee on Foreign Relations," 82d Cong., 1st Sess. 1770–71 (1951). At a conference sponsored by the State Department in October 1949, the consensus of the empaneled China experts, businessmen, and missionaries was for recognition of the People's Republic of China. "Transcript of Roundtable Discussions on American Policy Toward China, held in the Department of State, October 6, 7 and 8, 1949," in "Institute of Pacific Relations: Hearings before the Subcommittee of the Senate Committee on the Judiciary to Investigate the Administration of the Internal Security Act and Other Internal Security Laws," 82d Cong., 1st Sess. 1551–1682 (1952).

[5] On January 5, 1950, President Truman stated that "the United States will not provide military aid or advice to the Chinese forces in Formosa." XXIII Dep't State Bull. at 46 (July 10, 1950). A week later, Secretary of State Dean Acheson, in a speech before the National Press Club, defined the U.S. defense perimeter in the Pacific, excluding both Taiwan and South Korea. XXII Dep't State Bull. at 115–16 (January 23, 1950).

[6] See discussion in Spanier, "The Truman-MacArthur Controversy," at 114–27 (1959).

[7] Pres. Proc. No. 2914, 3 C.F.R. 99 (Comp. 1949–1953), 50 U.S.C. App. Notes prec. section 1 (1970).

[8] Foreign Assets Control Regulations, 31 C.F.R. Part 500 (1980).

[9] 31 C.F.R. sections 500.201 (a) and (b) (1980).

[10] Id.

[11] 31 C.F.R. section 500.201 (Schedule) (1979).

The frozen Chinese assets were first surveyed by the Treasury early in 1951, yielding a reported total of $105.4 million.[12] In subsequent years, some assets were unblocked pursuant to licenses granted by the Treasury under the Regulations. Similarly, new assets were blocked as a result of enforcement actions taken by the Treasury. In addition, certain assets were subject to appreciation and depreciation, with the body of frozen Chinese assets experiencing a net appreciation over time. When the frozen Chinese assets were next surveyed, beginning in 1970, the total value reported as of July 31, 1972 was $76.5 million.[13] This was later updated with additional reports to a total of $80.5 million valued at July 1, 1970.[14] No doubt there had also been appreciation, depreciation, unblockings and blockings since July, 1970, so that it is not advisable to treat the $80.5 million figure as a fixed and invariably accurate total. It is, nevertheless, the best (and only) approximation of the value of the frozen Chinese assets available.

The breakdown of the $76.5 million figure provides a general picture of the basic composition of the asset pool. Looking at the types of assets held, we see that 90 percent of the reported total consisted of either bank deposits ($53.2 million, 70 percent) or U.S. dollar securities ($15.5 million, 20 percent). The remaining 10 percent consisted of notes, drafts, and debts ($5.9 million, 8 percent) and all other types, including non-dollar securities, estates, trusts and insurance annuities ($1.9 million, 2 percent). Looking at the categories of owners of assets, we see that over half of the reported total was either owned by the PRC, including its governmental instrumentalities ($20.2 million, 26 percent), or held through third country banks ($23.6 million, 31 percent). The third country bank figure represented U.S. dollar accounts held by banks in the United States for foreign banks. In such cases, the foreign bank would have maintained dollar accounts in U.S. banks corresponding to accounts it maintained abroad in which the PRC or a PRC national had an interest. Another forty percent of the assets were split between individual owners ($15.2 million, 20 percent) and business entities, such as corporations, partnerships and unincorporated associations ($14.6 million, 19 percent). Finally, it appears that 91 percent of the assets reported ($69.5 million) were actually held by nineteen reporters, principally banks.[15]

These frozen Chinese assets remained blocked in a manner virtually unchanged until the implementation of the claims settlement, just over twenty-nine years in all. It should be pointed out that the transaction controls had been substantially modified, however, when President Nixon announced a relaxation of controls on trade with the PRC in May, 1971, and Treasury and Commerce removed restrictions on current non-strategic transactions with the PRC.[16] This relaxation came as part of the overall improvement in Sino-United States relations—in the wake of ping-pong diplomacy and on the eve of Nixon's trip to China—paving the way for a partial resumption of United States-PRC trade relations.

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[12] Department of the Treasury, 1970 Census of Blocked Chinese Assets in the United States, at 8 (unpublished).

[13] Id., at 2.

[14] Solomon, supra note 1.

[15] Department of the Treasury, supra note 12, at 3.

[16] 31 C.F.R. sections 500.546 and 500.547 (1979). For a comprehensive review of the blocked assets situation and the possibilities for settlement, see Bayar, "The Blocked Chinese Assets: Present Status and Future Disposition," 15 Va. J. Int'l L. 959-1008 (1975).

American Claims

The U.S. freeze on Chinese assets and the trade embargo in late 1950 did not pass unnoticed in China. Within a fortnight, the PRC government ordered all property of the American government and American enterprises placed under the "control" of local people's governments, and froze all private and public American deposits in China.[17] This marked the beginning of substantial loss of American property in China by all groups which had been active in China—government, businesses, charities, missionaries, and other individuals. But it was not until nearly 16 years later that the U.S. government took steps to ascertain the extent of loss, a prerequisite to seeking some means of compensation.

Because this American loss of property in China was not unique in the annals of U.S. foreign relations, it is instructive to glance briefly at the framework which has been created by U.S. government actions in dealing with analogous property losses elsewhere. In the immediate post-war period, the governments of several Eastern European states had generally nationalized foreign-owned property. Funds of some of these countries were blocked in the U.S. by the U.S. government, and were subsequently used to provide partial compensation to Americans whose property had been nationalized. Over time, most of these countries eventually reached claims settlements agreements with the U.S. government under which the foreign government agreed to provide additional funds to be distributed by the U.S. government to American claimants. These payments were accepted by the U.S. government in full and final settlement of the claims of U.S. nationals specified in the particular claims settlement agreement.[18]

After the conclusion of the first of these settlements, the first Yugoslav settlement, Congress passed the International Claims Settlement Act of 1949 (the Act) to enable the International Claims Commission in the Department of State to determine and certify nationalization claims under that settlement.[19] Congress also provided continuing jurisdiction for the International Claims Commission (replaced in 1954 by the Foreign Claims Settlement Commission (the Commission),[20] an independent executive agency) to receive and render final decisions on claims subsequently settled under en bloc settlements pursuant to bilateral government agreements, with the exception of claims against governments with which the United States had been in a state of war during World War II.[21] Subsequent titles were therefore added to the Act to provide for liquidation and payment into separate claims funds in the Treasury of Bulgarian, Hungarian and Rumanian assets which had been blocked by the United States during World War II (Title II);[22] to provide for the adjudication and payment of claims against Italy, the Soviet Union, Burgaria, Hungary and Rumania (Title III);[23] and to provide for adjudication and payment of certain claims against Czechoslovokia through liquidation of Czech assets blocked in the U.S. (Title IV).[24]

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[17] "Government Administrative Council Issues Order for the Control of American Government and Private Property in China," NCNA-English, Peking (Dec. 1950), in 38 Survey of China Mainland Press, Dec. 28, 1950, at 1.

[18] Rumania, Bulgaria, Hungary, Poland, Italy and the Soviet Union have entered into claims settlement agreements with the U.S. For a brief review of these settlements and related programs, see Foreign Claims Settlement Commission of the United States, 1979 Annual Report to the Congress, at 52–58. For discussion of particular settlements, see, e.g., Christenson, "The United States-Rumanian Claims Settlement Agreement of March 20, 1960," 55 Am. J. Int'l L. 617 (1961); Lillich, "The United States-Bulgarian Claims Agreement of 1963," 58 Am. J. Int'l L, 686 (1964); and Lillich, "The United States-Hungarian Claims Agreement of 1973," 69 Am. J. Int'l L. 534 (1975).

[19] The International Claims Settlement Act of 1949, Pub. L. No. 81–455, 64 Stat. 12 (codified at 22 U.S.C. 1621–1627 (1976)).

[20] Reorganization Plan No. 1 of 1954, 19 Fed. Reg. 3985 (1954). 68 Stat. 1279, set out as note foll. 22 U.S.C. 1622 (1976).

There had also been substantial U.S. property lost in Europe and the Far East as a consequence of World War II. These and similar war claims were adjudicated under Title II of the War Claims Act of 1948, also through the mechanism of the Commission.[25] In essence, this legislative scheme also had two stages: determination of the validity and amount of loss by the Commission; and proportional partial compensation for losses out of the War Claims Fund created through liquidation of German and Japanese assets blocked and vested during the War. Variations on this scheme had been applied in World War II and Korean conflict prisoner of war and civilian internee programs, which were funded by Congressional appropriations under Title I of the War Claims Act, and in similar programs added after the U.S.S. *Pueblo* incident and the conflict in Vietnam. Far more complicated in practice than this oversimplified summary may reveal, the War Claims programs were completed in the 1960's, with others continuing to the present date.[26]

In these property loss programs, the Commission had generally been authorized to adjudicate claims after either an agreement had been reached with the foreign government or assets were available for liquidation by the U.S. government for payment of claims. In the case of the claims against China and Cuba, however, no agreements had been reached by the mid-1960's, nor did agreements seem likely to be reached in the foreseeable future. Additionally, it was by no means clear that the substantial Chinese and Cuban assets frozen in the United States could be liquidated and paid over to U.S. claimants under existing law.[27] Nonetheless, the concerns of Americans with claims against Cuba were real and pressing, and prompted Congress in 1964 to enact Title V to the Act to provide for another mechanism: pre-settlement adjudication.[28] Behind this new law lay the concern that evidence of and witnesses to the Cuban seizures were becoming increasingly unavailable, the realization that prospects for settlement continued to be dim, and the judgment that it would be simpler for claimants to maintain one certificate of loss from the Commission rather than reams of documents and other evidence.[29]

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[21] 22 U.S.C. 1623(a) (1976).

[22] Pub. L. No. 84-285, 69 Stat. 562 (codified at 22 U.S.C. 1631-1631 (o) (1976)).

[23] Pub. L. No. 84-285, 69 Stat. 570 (codified at 22 U.S.C. 1641-1641 (q) (1976)).

[24] Pub. L. No. 85-604, 72 Stat. 527 (codified at 22 U.S.C. 1642-1642 (p) (1976)).

[25] The War Claims Act of 1948, 50 U.S.C. App. 2001 (1976).

[26] For a summary of the various programs authorized under the War Claims Act, see Foreign Claims Settlement Commission, supra note 18, at 9-12 and 50-52.

[27] Doubts about the propriety of such a vesting led to the 1965 repeal of a provision in the Cuban Claims Act (22 U.S.C. 1643j(b) (1964)) providing for vesting and liquidation of blocked Cuban assets in the U.S. Pub. L. No. 89-262, 79 Stat. 988 (1965). See S. Rep. No. 701, 98th Cong., 1st Sess. 3 (1965).

[28] Pub. L. No. 88-666, 78 Stat. 1110 (codified at 22 U.S.C. 1643-1643(1) (1976)). See Redick, "The Jurisprudence of the Foreign Claims Settlement Commission: Chinese Claims," 67 Am. J. Int'l L. 728, 729 (1973).

With this Cuban program finally established, Congress was persuaded—by, among others, the controlling interests in what was to be the largest single claimant under the China Claims program, the Shanghai Power Company [30]—to add claims against China to Title V. Thus, on November 6, 1966, Congress authorized the Commission to "receive and determine . . . the amount and validity of claims by nationals of the United States against . . . the Chinese Communist regime, arising since . . . October 1, 1949, . . . for losses resulting from the nationalization, expropriation, intervention or other taking of, or special measures directed against property including any rights or interests therein owned wholly or partially, directly or indirectly, at the time by nationals of the United States." [31] The Commission issued its notice of the China Claims Program in January, 1968,[32] and provided the maximum 18-month claims filing period allowed by the Act. As required by law, the Commission completed its determinations and certifications of losses of property in China by July, 1972.[33]

Before analyzing the composition of the 378 awards (technically referred to as "certifications of loss") made by the Commission, some of the restrictions on the eligibility of claims under the China Claims Program should be pointed out. First, only claims for losses arising between October 1, 1949 and November 6, 1966 were considered. Because the claims were against actions by the Chinese Communist regime as a government, losses incurred prior to its establishment in 1949 could not be included; because Congress authorized the Commission to hear claims on November 6, 1966, the Commission took that date as the cut-off date for the China Claims Program. Second, the Act only permitted consideration of claims for losses of property owned by American nationals on the date of taking, and then only to the extent that the claim had been held by a U.S. national continuously until the date of filing with the Commission.[34] Third, individual claims based on ownership of corporations and other legal entities, such as stockholders' or shareholders' claims, could not be considered at all for losses incurred by U.S. corporations or other entities. The corporate entity itself would have to file a claim. The statutory test for corporate nationality was that the entity be organized under U.S. law and that 50 percent or more of the beneficial ownership rest with U.S. citizens.[35] Individuals' claims based on ownership interest in corporations or other legal entities not meeting this statutory test could only be considered in proportion to the individual American's interests.[36]

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[29] S. Rep. No. 1521, 88th Cong., 2d Sess. 8 (1964).

[30] Claims of Nationals of the United States Against the Chinese Communist Regime: Hearings on S. 3675, 89th Cong., 2d Sess. 14 (1966). (Statement of Kenneth B. Sprague, Vice-President, American and Foreign Power, Inc.)

[31] Pub. L. No. 89-780, 80 Stat. 1365 (codified at 22 U.S.C. 1643b(a) (1976)).

[32] 33 Fed. Reg. 241 (1968).

[33] Foreign Claims Settlement Commission of the United States, 1972 Annual Report to the Congress, at 417.

[34] 22 U.S.C. 1643c(a) (1976).

[35] 22 U.S.C. 1643(a)(1)(B) (1976).

Within these statutory constraints, the Commission considered a total of 579 claims, and issued 378 awards and 198 denials. Three claims were withdrawn. The 378 awards were certified to the State Department, and to some 443 claimants holding 378 claims for a total of $196,861,841.[37] Three hundred sixty individual claimants were issued awards totalling $14,457,723; 34 claimants in the religious and other nonprofit organizations category were issued awards totalling $58,266,394; 43 corporate claimants were issued awards totalling $122,743,554; and 6 claimants for other business entities were issued awards totalling $1,394,170. Nineteen of these awards were over $1 million each, eight for business corporations, ten for religious and other nonprofit entities, and one for an individual.[38]

The China Claims Program authorized under the Act did not provide for payment of the claims on which awards had been made. What was provided was an authoritative figure for pre-1966 losses ($196.9 million) which could be used by the U.S. government when it was prepared to negotiate a settlement with the PRC for the $80.5 million in frozen Chinese assets.

The Settlement

While Sino-U.S. political confrontation in the late 1940s and early 1950s created the claims/assets problems, Sino-U.S. economic cooperation of the 1970s necessitated its solution. The effect of this problem on blossoming Sino-United States trade after 1971 can be traced to the interrelationship between American claims and the frozen Chinese assets. So long as American claimants remained uncompensated for their losses in China at the hands of the Chinese government, there remained the possibility that they would seek to attach Chinese government assets in the United States to satisfy their claims, even after the Regulations were amended in 1971 so that the PRC was no longer generally prohibited from entering into transactions in the United States. PRC government assets used for diplomatic and noncommercial purposes were likely to be protected from attachment, in any case, by the doctrine of sovereign immunity.[39] Though the likelihood of attachment of PRC commercial assets may have been reduced by the passage of the Foreign Sovereign Immunities Act of 1976,[40] which specified the extent to which commercial assets were reachable by U.S. claimants, the possibility of attachment remained, and with it, the PRC fear of harassment. There was also concern that the frozen Chinese assets themselves might, if unfrozen, be subject to similar attachment.[41] Thus, it became apparent that any true normalization of

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[36] 22 U.S.C. 1643d (1976).

[37] Foreign Claims Settlement Commission, supra note 18, at 71. Interest from date of loss to date of settlement at 6 percent per annum was also awarded.

[38] Foreign Claims Settlement Commission, Summary of the China Claims Program (June 4, 1979).

[39] See, e.g., discussion in Steiner & Vagts, "Transnational Legal Problems" 646–672 (Second Ed. 1976). The question could have been complicated by U.S. non-recognition of the PRC.

[40] Pub. L. No. 94-583, 90 Stat. 2891 (codified at 28 U.S.C. 1602–1611 (1976)). See particularly 28 U.S.C. 1605(a)(3).

[41] See Bayar, supra note 16, at 1000.

Sino-United States trade would require the settlement of the claims/assets issue.

The U.S. side was faced with two concerns in finding a solution that would achieve reasonable satisfaction of U.S. claimants: level of recovery and form of settlement. As for the level of recovery, previous settlements of nationalization claims against Eastern European nations had recovered less than 100 cents for each dollar lost, ranging from 36 cents with Hungary on up to over 90 cents in the first Yugoslav settlement. The 1933 Litvinov Assignment with the Soviet Union yielded 12 cents on the dollar—after more than twenty years of litigation at that.[42] While an agreement in principle with China which was rumored to have been reached in 1973 would likely have been in the 40 cents on the dollar range,[43] Congress had in 1975 signified its dissatisfaction with a Czechoslovakian claims settlement in the same range.[44]

As for form of settlement, the proposed 1973 settlement would have been on a mutual assignment basis. Under a mutual assignment, such as the Litvinov Assignment, the United States would have assigned to the PRC all the interests of U.S. nationals in property which had been taken in China. The PRC would have assigned to the U.S. all PRC interests in blocked property in the United States. The PRC would have had to satisfy the claims of its nationals for the loss of blocked property in the United States out of property assigned to it in China. The United States would have had to satisfy the claims of its nationals for loss of property in China out of the PRC interest in blocked property assigned to the United States. Theoretically, that would have yielded roughly 41 cents on the dollar.

In practice, however, collection of that 41 cents would surely have proved elusive. The United States could have received title to the blocked property only as good as that of its assignor, the PRC. Yet, as noted above, these assets were blocked under the Regulations not because of PRC or PRC national ownership, but rather because of the existence of a PRC interest of any nature whatsoever, direct or indirect, in the property. There was no guarantee of the strength of PRC title to the assets. For example, individuals might have left the mainland, but failed to claim their assets in the United States after their departure, or third country nationals might have owned property that was in fact blocked because of a PRC interest. As as result, the United States would more than likely have found itself in protracted litigation over title to the assets, as it did under the Litvinov Assignment. Additionally, in the Litvinov settlement, it had been possible to rely, in litigation, on official Russian decrees which had previously nationalized the property at issue.[45] No similar decrees were known to be available in the Chinese situation, and the absence of official action, combined with probable factual uncertainties, could have made proof of ownership extremely difficult. Such an assignment, then, could well have yielded the U.S. government less than $30 million for actual distribution to United States claimants.[46]

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[42] Solomon, supra note 1. The Litvinov Assignment is found as Exchange of Letters between Soviet Commissar for Foreign Affairs Litvinov and President Roosevelt, Nov. 16, 1933, in Dep't of State, Establishment of Diplomatic Relations with the Union of Soviet Socialist Republics (East European Series No. 1, 1933).

[43] N.Y. Times, May 17, 1973, at 16, col. 1.

[44] Trade Act of 1974, Section 408, Pub. L. No. 93-618, 88 Stat. 1978 (codified at 19 U.S.C. 2438(a) (1976)).

[45] See *U.S.* v. *Pink*, 315 U.S. 203, 210-11 (1942).

Unlike the Litvinov Assignment, the settlements with the Eastern European nations had typically involved both a cash payment by the foreign government and the liquidation of blocked assets in the United States which had been vested by the U.S. government under specific legislation. The China legislation did not provide for vesting of the blocked assets, and it was not clear that the option of vesting under other legislation was available in the China situation.[47] Thus, the combination of vesting and liquidation with a cash payment did not appear to be satisfactory either.

The Chinese side was concerned with return of the frozen assets to rightful owners. The mutual assignment proposal posed a problem in this regard. The PRC would have needed to know which assets had been recovered by the United States in order that some compensation be made to PRC nationals whose property in the United States would have been taken under assignment. Because the U.S. government stood by its position of maintaining the confidentiality of its information about the ownership of specific assets, the PRC would then have faced difficulty in ascertaining the validity of its nationals' claims.[48]

The Agreement Concerning the Settlement of Claims between the United States and the People's Republic of China of May 11, 1979[49] (the Agreement) as concluded took account of these and other difficulties which had plagued both sides. The PRC agreed to pay $80.5 million to the U.S. government, $30 million on October 1, 1979, and the balance of $50.5 million in five equal annual installments of $10.1 million each, beginning on October 1, 1980. The U.S. agreed to unblock the frozen Chinese assets by October 1, 1979, although the two sides thereafter exchanged notes on September 28, 1979, extending the date to January 31, 1980. These mutual undertakings were accepted by the two sides in satisfaction of the claims of U.S. nationals against the PRC for the taking of property by the PRC between October 1, 1949 and May 11, 1979 (the effective date of the Agreement) and of the claims of the PRC and its nationals arising from the blocking of assets between December 17, 1950 and May 11, 1979. Thus, the United States was assured of receiving $80.5 million for distribution to claimants, while the PRC itself would be in a position to recover PRC assets in the United States. With the claims settled, trade between the two sides could proceed to develop, unhampered by the threat of attachment by unsatisfied claimants.

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[46] Mundheim, "Claims/Assets Agreement with PRC: What It Means, How It Was Negotiated," in Business America, July 16, 1979, at 7.

[47] Doubt had been cast on the viability of a possible peacetime vesting, as would have been the case here, by dicta in the Sardino case. *Sardino* v. *Federal Reserve Bank*, 361 F.2d 106.1-11 (2d. Cir.), cert. denied, 385 U.S. 898 (1966). Moreover, given the broad definition of "interest" used in the Regulations, it could have been administratively complex to select out the non-enemy interests not properly subject to vesting. Finally, when the Trading with the Enemy Act, which had formed the basis for the Regulations, was replaced by the International Economic Emergency Powers Act, currently-exercised authorities were extended. 50 U.S.C. 1706 (1976). Whether vesting authority which had not been exercised with respect to Chinese assets could have been extended is unclear. IEEPA itself does not provide vesting authority.

[48] Mundheim, supra note 46, at 7-8.

[49] Agreement Concerning Settlement of Claims, May 11, 1979, United States-People's Republic of China, T.I.A.S. 9306.

Implementation

For its part, the U.S. had four main responsibilities to fulfill. First, in Article II(b) of the Agreement, the U.S. agreed to notify holders of blocked assets (which the records of the U.S. indicated were held in the name of residents of the PRC) of the PRC government request that assets of the PRC not be transferred or withdrawn without PRC consent. That notification was made in July, 1979. At the same time, the U.S. government undertook to assist the PRC in its recovery of those assets by channeling information from holders of those assets to the PRC, to the extent possible consistent with U.S. policy on protecting the confidentiality of information.[50]

Second, the United States needed to ascertain the full extent of claims of U.S. nationals settled by the Agreement. The previous figure of $196.9 million, discussed above, only represented awards made in the China Claims Program, which covered losses incurred between October 1, 1949 and November 6, 1966. Claims for losses arising between November 6, 1966 and May 11, 1979 remained to be determined. As a practical matter, the absence of extensive U.S.-owned property in the PRC during the period made it unlikely that substantial awards, if any, would be made by the Commission. After the Agreement was signed in May, 1979, the Commission announced a new filing period for post-1966 claims, from June 1 through August 31, 1979, to be carried out under the basic authority of Title I of the Act referred to above.[51] The Commission completed its work on the post-1966 claims on July 31, 1981.[52] A total of 82 claims were filed, on which the Commission issued 3 awards totaling $176,455.[53]

Third, the U.S. was responsible for distribution to U.S. claimants of the payments made by the PRC. The first $30 million was received on October 1, 1979, as scheduled, and Treasury's Bureau of Government Financial Operations shortly thereafter began the process of making payments to claimants whose claims had been certified to Treasury by the Commission, in accordance with the Act. Title I of the Act requires that five percent of the payment made to the U.S. be paid into Treasury's miscellaneous receipts as reimbursement for U.S. government administrative expenses.[54] Then, persons with awards of $1,000 or less receive the full value of their awards. Persons with awards of over $1,000 receive $1,000 plus a pro rata share of the funds which then remain. Interest can be paid on the claims only if the principal on all awards has been paid.[55] Since the amount available for distribution is substantially less then the total principal amount, no interest will be paid on the claims.

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[50] Letter from Stanley Sommerfield, Director, Office of Foreign Assets Control, Department of the Treasury, to holders of blocked Chinese asets (July 13, 1979).

[51] 44 Fed. Reg. 31711 (1979). For a brief description of the program, see Foreign Claims Settlement Commission, supra note 18, at 34-38.

[52] Id.

[53] Foreign Claims Settlement Commission files.

[54] 22 U.S.C. 1626(b)(2) (1976).

[55] 22 U.S.C. 1627(e) (1976).

After distribution of the first $30 million had already begun, legislation was passed by Congress to alter this distribution formula.[56] Awards to business entities which had previously reduced their federal tax liability by taking deductions for the loss of claimed property in China will be reduced by the amount of such federal tax benefit, as defined in the law. Payments on the basis of such reduced awards will be correspondingly reduced. All such reductions in payment will then be aggregated and distributed on a pro rata basis to claimants which were nonprofit or charitable organizations on the date of the taking of the property. The law was passed by Congress on October 1, 1980,[57] the same day that the PRC check for the second installment of $10.1 million was received by the Treasury. Thus, distribution of the first $30 million to business entity and charitable claimants was not affected by the change in formula, but the distribution of all other installments ($50.5 million will be.[58] However, it must be borne in mind that given the many ways in which the federal tax benefit, as defined, could have accrued to another entity, such as a parent company, it may well be that very few business entity claimants will in fact have their payments reduced.

Fourth, the U.S. was required to unblock the frozen Chinese assets. The October 1 date (the thirtieth anniversary of the founding of the PRC and the start of the U.S. government's fiscal year) was postponed on the eve of unblocking to "facilitate the orderly distribution of the assets after unblocking."[59] Presumably, this was to help both the PRC government in its preparations for claiming the assets and the American holders in preparing to turn them over to their rightful owners. On January 31, 1980, the new date chosen, the blocking of the assets was ended, with one exception.[60] Holders of blocked assets were prohibited from turning the assets over to state governments as abandoned property until January 31, 1982. Several states had previously been licensed by Treasury to take custody of blocked assets under operation of state abandoned or unclaimed property laws.[61] The two-year moratorium prevented such transfers until its expiration, assisting the owners of the frozen Chinese assets in tracing them to their original holders, rather than through the states.

As for the PRC, it is responsible, first, for making the payments to the U.S. government for distribution to claimants, which it has done thus far in a timely manner. Second, the PRC bears the burden of recovering as much as posssible from the now-unblocked assets. In that regard, the PRC State Council issued a decree on

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[56] Pub. L. No. 96-445, 94 Stat. 1891 (to be codified at 22 U.S.C. 1627(f) (Oct. 13, 1980)).

[57] The House passed H.R. 6440 on September 30, 1980. 126 Cong. Rec. H10132 (Sept. 30, 1980). The Senate passed H.R. 6440 on October 1,1980. 126 Cong. Rec. S14035 (Oct. 1, 1980).

[58] Pub. L. No. 96-445, 94 Stat. 1891 (Subsection (f)(2)(a)).

[59] Department of the Treasury, Press Release, "Treasury Announces Postponement of Date for Unblocking of Chinese Assets," Sept. 28, 1979. 44 Fed. Reg. 56434 (1979).

[60] 45 Fed. Reg. 7224 (1980).

[61] For example, the State of New York held over $2 million in frozen Chinese assets as abandoned property. Letter from N.Y. State Controller Edward Regan, at N.Y. Times, Sept. 24, 1979, at 18, col. 6.

September 9, 1979,[62] authorizing the Bank of China to act on behalf of government offices, state enterprises, public agencies inclusive of corporate bodies, educational institutions, et al., whose assets were blocked by the U.S. government, in recovering or withdrawing those assets from the American holders. The decree also prohibited organizations and individuals from withdrawing, transferring or selling blocked assets without the consent of the Bank of China. The Bank of China was authorized to make payments to the parties concerned in such cases in accordance with relevant government regulations. For payments still being made, such regulations are likely to include the 1981 Foreign Exchange Control Regulations.[63] Generally, a Bank of China announcement, in September, 1979, stated that after recovery of individuals' assets by the Bank of China, the value would be returned to the owners: up to ten percent in foreign currency, with the benefits of remittances from abroad to apply to renminbi balance.[64]

What effect this decree has had and will have on the distribution of the assets now that they are unblocked is not entirely clear. First, the Bank of China would still need to demonstrate title to assets to reclaim them from American holders, even though the Bank's authority to represent PRC owners is contained in the State Council decree. Secondly, as a matter of PRC law, PRC organizations and individuals are not authorized to seek to recover the unblocked property in the United States without the consent of the Bank of China. Whether U.S. holders will apply that PRC law to the claims made for assets held in the United States—and whether U.S. courts would require them to apply PRC law in any litigation that might ensue—will surely depend on the circumstances of ownership of the particular assets in question, as well as on the relevant legal doctrines. Intriguing, too, is the question of whether the PRC will stray from its characteristic reluctance to litigate, and go to court to enforce its rights to some of the assets if competing claimants choose litigation over negotiation.[65]

The question of the PRC's inclination to litigate may play a role in another area as well. In its July, 1979 notification to holders, the U.S. government transmitted a second message from the PRC: that the government of the PRC "requested that the question of interest payments on blocked assets in non-interest bearing accounts prior to March 2, 1979 be settled through direct negotiations between the Bank of China and the institutions holding such accounts." [66] This question had previously been left open by Treasury's amendment to the Regulations on March 2, 1979, which required that blocked assets be maintained in interest-bearing accounts, without affecting interest prior to that date.[67] Indeed, there was concern on the part of certain U.S. holders that Federal Reserve Regulation Q would in fact prohibit the payment of interest on blocked accounts prior to March 2, 1979. However, the General Counsel of the Board of Governors of the Federal Reserve System has taken the view that the Board could approve the payment of interest on these blocked accounts prior to March 2, 1979.[68] Payment could be approved where the payment was required by a court judgment; where the payment was made in avoidance of litigation, as a settlement found reasonable in light of all factors by the holder's legal counsel; and where future banking services were provided at a reduced rate in the future. Thus, the PRC may at least need to consider litigation in order to receive payments of back interest on blocked accounts to which the Federal Reserve's Regulation Q would apply.

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[62] State Council (People's Republic of China), Decree [Concerning Implementation of the Agreement between the People's Republic of China and the United States of America on the Settlement of Claims of May 11, 1979], Sept. 9, 1979.

[63] State Council (People's Republic of China), Provisional Regulations for Exchange Control, promulgated Dec. 18, 1980, effective Mar. 1, 1981.

[64] Announcement of Bank of China, Xinhua, Beijing, Sept. 9, 1979.

[65] A settlement of long-standing litigation between the Shanghai Power Company and certain of its preferred stockholders and debenture holders, many of whom are PRC residents, is underway in Delaware Court. *Shanghai Power Company* v. *Delaware Trust Company*, (No 3883. Chancery Court, New Castle County). Claims have been filed by or on behalf of PRC residents.

[66] Sommerfield, supra note 50.

[67] 44 Fed. Reg. 11764, 11765 (1979), codified at 31 C.F.R. section 500.205 (1981).

In the 3 years since the settlement was concluded, Sino-American economic relations have indeed progressed, as documented elsewhere in these volumes. The resolution of the claims/assets problem was by all accounts a prerequisite for that progress, and while the implementation process continues—the last PRC payment is not due until October 1, 1984—the settlement itself is primarily of historical significance. The PRC had not previously entered into private claims settlements, although government-related claims had been settled by the PRC in isolated instances.[69] The form of settlement, moreover, was without precise precedent in the voluminous history of U.S. claims settlements. Overall, the United States-China claims settlement met its goals in a unique way, and if traces of discontent with its particulars can be found among American claimants or Chinese bureaucrats, perhaps that is testimony to the balance of political compromise which the settlement represents.

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[68] Letter from Federal Reserve General Counsel to Chief Counsel, Office of Foreign Assets Control, U.S. Department of Treasury, (December 21, 1979).

[69] As of 1976, it had been reported that the PRC had not "entered into any agreements to compensate foreign nationals for appropriation of property after 1949." Lubman, "Trade Between the United States and the People's Republic of China," in 8 Law and Policy in Int'l Bus. 1, 57 (1976). The PRC did compensate the government of Canada for losses based on a 1946 bank loan guaranteed by the Canadian government and for losses of certain official property in China. Copithorne, "The Settlement of International Claims Between Canada and China: A Status Report," in 48 Pacific Affairs 230 (1975). The governments of Great Britain and the PRC were reported in 1981 to be considering a claims settlement. Financial Times, Jan 6, 1981.

U.S. FIRMS IN THE PRC TRADE (THE SWEET AND SOUR CHINA MARKET)

By Henry J. Groen

I. INTRODUCTION

The China market, a place for U.S. companies to buy and sell goods and services, has historically held a promise of fortune. As relative late comers to the market place of "New China", U.S. firms still sense the old promise, but for many, initial high hopes have moderated. During the early 1970's, after the 21-year trade embargo was lifted, newly gained access to a quarter of humanity enticed U.S. company executives en masse to draw up plans for capturing just a small percentage of the China market, which appeared vast from the viewpoint of a single company.

At present, there is not a very big pie for so many eager U.S. firms to share. While some American companies have faired well in China, a few very well, most have not. Substantial gains for the majority of U.S. companies in China will be made in the longer term. The economic constraints on a rapid, across-the-board plan for development, like the Four Modernizations, have been classically illustrated in China in the past 3 years. Though foreign equipment purchases may be financed by foreign loans, sometimes at give away interest rates, the country cannot afford internally the concomitant building and shoring up of the infrastructure to make effective use of an unrelenting inflow of capital goods. Add to this situation the desire of the government to improve personal consumption, as China has done, and the country quickly has too much money chasing too few goods—inflation.

While many countries are willing to finance development with inflation, China is not. A jump to double digit inflation from stable prices 3 years ago was a shock, resulting in the present policy of Readjustment. Realigned priorities in economic policy now exclude many projects that were being negotiated by U.S. companies when the crunch came. Readjustment in the arena of foreign trade means that selling to China, while never easy in the past, will for the next two or three years be even tougher. The highly public contract cancellations and heavy industrial withdrawal has hurt China's credibility as an important trading partner with the West, yet even with the bad press, the potential of the China market is still respected by U.S. firms.

Now that U.S. company executives have had time to assess the effects of Readjustment on their businesses, I have attempted to find out their collective opinion of the China market through a mail survey, the results of which are presented and analyzed in this paper. Section II lists the questions and answers of the survey with brief explanations where necessary. Section III examines the relationship between some of the survey answers in the context of selling to China. Section IV discusses buying from China. The role of intermediaries or trading companies is discussed in Section V, followed by Section VI, Conclusions.

II. Opinion Survey of U.S. Companies Doing Business in China

The questionnaire used in this survey was designed to probe common ground, since companies in the sample population are of diverse activities and size. Anonymity was insured to evoke candid answers. To maximize the number of responses the survey was limited to one page and made easy to fill out. I received 65 completed questionnaires from an original mailing of 125. The sample population consists of America's largest industrial corporations, banks, and retailers doing business in China. Nearly all the industrial corporations are listed in the Fortune 500. I sent letters to the chief executive officer (CEO) of each company since the survey deals directly with the decision process, therefore the person actually responding to the questionnaire, if not the CEO, would be someone answering for him.[1]

The survey questions are listed below with the percentage of respondents to the right of each answer they chose. Some of the questions are annotated in this paper.

1. When did you first make business contact with China? (Circle one)

	Percent
A. 1972 or before	27.7
B. 1973-74	24.6
C. 1975-76	10.7
D. 1977-78	18.5
E. 1979-80	18.5

The U.S. embargo on trade with China was relaxed in May of 1971.

2. You are involved in: (Circle applicable)

	Percent
A. Exports to China	78.5
B. Imports from China	44.6
C. Compensation Trade	16.9
D. Joint Venture	16.9
E. Services in China	16.9

Percentages do not round to 100, because categories are not mutually exclusive.

3. Your signed contracts with China are worth: (Circle one)

	Percent
A. None signed	31.1
B. Under $500,000	6.6
C. $500,000 to $1,000,000	1.6
D. $1,000,000 to $5,000,000	23.0
E. $5,000,000 to $10,000,000	6.6
F. More	31.1

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[1] The author expresses much appreciation to the corporations that took time to respond to the survey. It is hoped they will benefit from analysis of the cumulative information.

It is important to distinguish between companies actually doing business and those in preliminary phases. Often a signed contract is smaller than amounts discussed in preliminary phases.

4. So far, would a cost-benefit analysis of your activity in China: (Circle one in each pair)

	Percent
Show disappointing results?	
A. Yes	46.4
B. No	53.6
Compare favorably to other new markets?	
A. Yes	60.7
B. No	39.3
Suggest it's time to cut back efforts?	
A. Yes	17.3
B. No	82.7
Indicate business is good?	
A. Yes	31.2
B. No	68.8

5. Irrespective of costs, your hopes for a substantial slice of the "China Market" are: (Circle one)

	Percent
A. Very high	3.2
B. High	36.5
C. Not as high as before	36.5
D. Low	23.8
E. Dead	0.0

This is an important question in evaluating motivation in China. An interesting correlation is tested in a later section using these answers.

6. In a country like China (non-market economy, language barrier, large bureaucracy, etc.) trading companies provide a valuable service to U.S. firms.

	Percent
A. Agree	41.5
B. Disagree	27.7
C. Don't know	30.8

The subject of trading companies is broad and is only examined in this paper as an aid to solving some of the problems encountered by U.S. companies while doing business in China.

7. You entered the China market based upon: (Circle one most appropriate)

	Percent
A. Gut reaction	4.7
B. Personal evaluation	48.4
C. Internal company advice	34.4
D. Careful study using outside experts	12.5

8. Your expectations of a payback period from an investment in the China market are: (Circle one)

	Percent
A. 1 to 2 years	9.3
B. 3 to 4 years	20.4
C. 5 to 6 years	24.1
D. 7 to 8 years	25.9
E. Longer	20.3

Taking midpoints and assuming E is 9 to 10 years, the mean expected payback period is 6.25 years when weighed by the percentages of responses.

9. China's honor of contractual obligations compared to other countries is: (Circle one)

	Percent
A. Superior	18.9
B. About the same	69.8
C. Inferior	11.3

After the widely published contract cancellations during Readjustment, it is interesting to see how U.S. business executives view the Chinese on the critical issue of contracts.

10. Please comment briefly about your satisfaction or dissatisfaction with the China market.

A list of comments from many of America's largest companies is provided as an appendix to this paper.

III. SELLING TO CHINA

As the survey indicates, most major American companies in China are there to sell. A powerful attraction for U.S. sellers of industrial equipment sprung up very shortly after the embargo came off. Many thought of China as virgin territory, even though Europe and Japan had been calling there for years. Question No. 7 of the survey shows that the CEO has decided himself, in most cases with minimal outside expertise, that the company was going into China. Early successes by some large industrial companies, like Kellogg and Boeing, as well as the major grain traders, undoubtedly contributed to a bandwagon effect. The desire to see China has probably been a stronger influence than executives are likely to admit.

Though growth in volume may be slow, evidence shows that the longer a company trades with China the better it does in total business. As the Chinese are fond of saying, "We do not forget old friends." In Figure 1, regressing the amount of signed contracts on when the company started trading with China shows significant positive correlation.[2]

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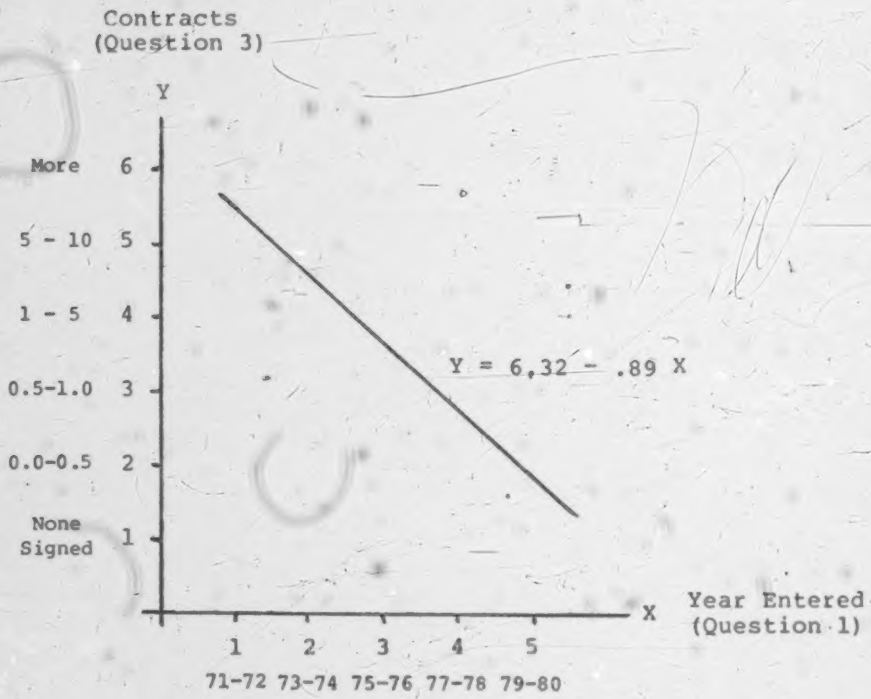
[2] In this regression analysis and those that follow, it must be remembered that rankings of most of the variables are only ordinal. In addition, the rankings on the questionnaire's scales by CEOs are subjective judgments. Therefore, trends cannot be measured with precision, even though the formula for a line has finite numbers attached to it. Numbers on X and Y axes correspond to lettered answers of the questionnaire (A=1, B=2, etc.). Numbers of observations vary because some respondents avoided answering some questions.

Figure 1

Amount of Signed Contracts

Depending Upon Year Entered China Market



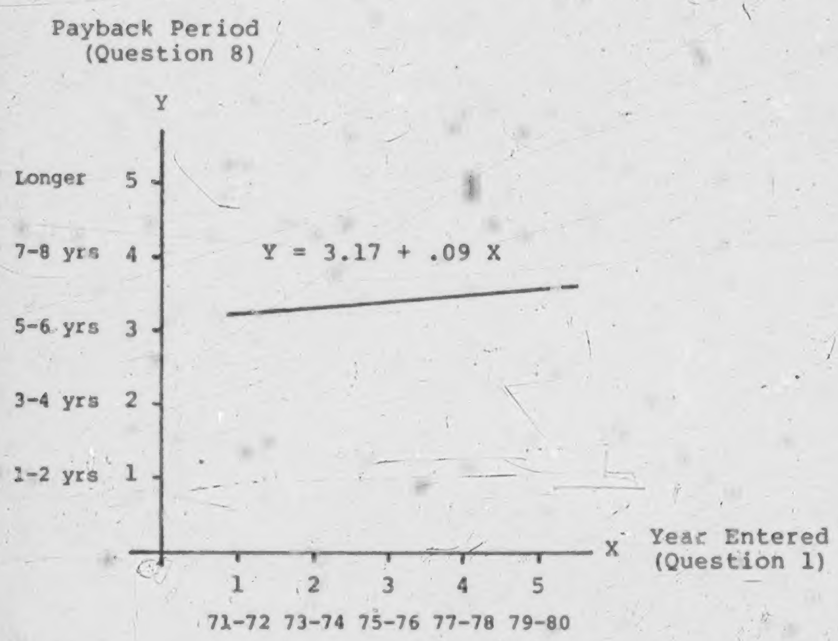
Note: T - Statistic (-5.5) for slope of line is significant at 95% confidence level. r = -.63, 57 observations.

Companies complain about the waiting in China, but on the average they now seem to be going in with their eyes open to this problem. The slope of the regression line in Figure 2 does not test out significantly different than zero, meaning that regardless of when a company from the sample went into China, the mean expected payback period is about six years. Expectations are rather widely disbursed, but no more for new entrants than for old. Also indicating patience with the China market are the third and fourth parts of question four of the survey. While 68.8 percent said that a cost benefit analysis would not indicate business is good, 82.7 percent said it was not yet time to cut back efforts.

Figure 2

Expected Investment Payback Period

Depending Upon Year Entered China Market



Note: T - Statistic (0.71) for coefficient of X strongly indicates the slope is not significantly different from zero. r = .10, 53 observations.

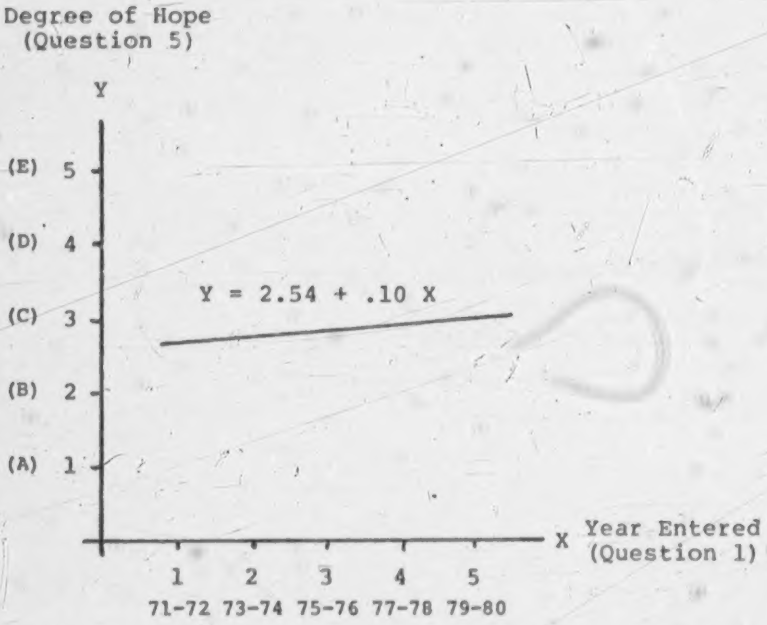
The realities concerning the size of this new market now appear much better understood by U.S. businessmen. China has monumental needs, but limited foreign exchange. At the same time the deficiencies of the economic infrastructure, particularly transportation, constrain the growth of industry and therefore the amount of foreign loans the country can absorb over a fixed period. American businessmen have found out that competition for major projects that are going forward can be very keen. For example, nearly 50 oil companies presently seek to develop China's offshore oil reserves.

Getting the opportunity to bid on a project does not seem so special in the 1980s as it did in the 1970s. Large U.S. firms now realize their competitors are probably also talking to the Chinese. In Figure 4, regressing the degree of "hope for a substantial slice of the China market" on when the firm got involved in China shows no correlation. In 1981, U.S. companies just entering the China market, on the average, have no higher or lower hopes for big volume business than those that have been in China since 1972.

Figure 3

Hopes for Large Volume Business

Depending Upon Year Entered China Market



Note: T - Statistic (1,43) for coefficient of X strongly indicates the slope is not significantly different from zero. r = .18, 64 observations

MATCHING SELLING EFFORTS WITH PRC ECONOMIC PRIORITIES

> China is now in a period of national economic readjustment. In our economic activities with foreign countries and enterprises, we will pursue an energetic and prudent policy which will be beneficial to the readjustment of our national economy. Absorbing foreign funds, importing technology, and running joint ventures must not overreach our resources. They must be done progressively, contributing to correcting the disproportions in our current national economy and to strengthening its weak links.[3]

The quotation is a key to understanding where the opportunities now lie for U.S. firms in China. The "weak links" are listed below in order of national priorities for the early 1980s.

(1) The exploration of energy sources of petroleum, coal, and electricity;

(2) The construction of railways, ports, telecommunications, building materials, and the infrastructure in urban and industrial zones;

(3) The small and medium-sized projects, requiring small investments but bringing quick economic results to help expand exports and increase foreign exchange earnings, such as in light, textile, chemical, metallurgical, machine building, electronics industries and tourism;

(4) Technical transformation of existing enterprises;

(5) Some ongoing projects to be deferred or stopped owing to a lack of funds.[4]

Energy and transport (1 and 2) have long been high on China's list of development priorities. U.S. companies are active in these areas and will continue. The most significant potential for new sales now lies in the broad area described in priority 3, almost totally aimed at the household consumer, Chinese and foreign.

China will probably never become the mass market some US manufacturers, such as toy or tobacco companies would hope for. However, there are numerous light industrial manufacturing processes which the US can assist through sales of licensing, equipment, and specialty items. Many raw materials, such as lumber, fibers, plastics, and leather can also be sold in increasing quantities to Chinese light industry.

Import restrictions on mechanical and electrical products, a new barrier to foreign sales, are presently being called for to help keep foreign trade in balance, but more importantly to encourage domestic growth of light industry, which in contrast with heavy industry, provides more jobs and revenue with less capital input. The restrictions are to be directed mostly at consumer durables such as televisions, tape recorders, and calculators, but automobiles are on the list. The ubiquitous Japanese taxi has caught on in China as in most of Asia. Before decentralization a restrictive policy such as this would never have had to be debated in the press as it is now. Central planners would have just cut out purchases they did not want to make. Inroads to the domestic consumer market by Asian industrial countries have been remarkable in recent years. As stated in the People's Daily, "In 1979 and 1980 the number of imported television sets topped the output of homemade sets by 9 percent."[5] The editorial advocated that no more motor vehicles or television sets should be imported, admitting that inadequate and poor quality Chinese products were to blame but also arguing for the protection of domestic industry.

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[3] Speech by Ji Chongwei, International Symposium on World Economy, jointly sponsored by Chinese Academy of Social Sciences and Stanford Research Institute International, March 23-28, Hangzhou. Reported in Beijing Review, April 20, 1981, p. 15.

[4] Ibid.

From watching the news media, selling consumer goods to China appears tougher than ever. However, visible signs of successful foreign sales continue to appear. New air conditioned Japanese taxis have begun plying the streets of Peking for premium fares. Coca Cola, formerly sold only to foreigners, now is sold to Chinese, at two or three times the price of the local orange soda.

Giving China a way to pay for foreign consumer goods, such as earning money from the foreigners in China; or jointly producing the product, as at the Coca Cola bottling plant in Peking; or paying through compensation trade now more than ever looks like the approach to consider. The government wants to soak up some of the excess money in the country through sales of consumer goods, but at the same time wants to minimize the outflow of foreign exchange to obtain the products. In the mail survey above, of the US companies exporting to China, over half are also importing.

IV. BUYING FROM CHINA

Petroleum, coal, and minerals have a bright outlook as future earners of foreign exchange, but prospects are long range, especially with domestic demand for these resources growing. Traditional exports such as handicrafts and processed foods, will continue to be important, but significant growth is unlikely. Through Readjustment China sees a way, in the short term, to make gains in exports by broadening the manufacture of consumer durables. A good example of the potential is textiles, just one area of the consumer market which has experienced tremendous growth in demand by US buyers in a very short period, most coming since tariffs were lowered with the granting of favored nation tariff status. Light manufacturers have the added advantage of building in high value through labor, making economic use of raw materials.

In another People's Daily article, "Make an Effort to Increase the Export of Mechanical and Electrical Products", the desires of every foreign buyer in China were put succinctly. "Factors which determine increases in exports are mainly excellence in quality, suitability for sale and competitiveness in prices, as well as punctuality in goods delivery . . ."[6] American buyers have been tolerant of sharply increased prices of native Chinese handicrafts accompanied by slow delivery, because world demand is high, and there is nowhere else to go for the genuine article. But growth in exports of common consumer durables and daily use items has been disappointing to the Chinese, who know from having studied the economic miracle in Japan that western consumers, particularly Americans, have a lot of money to spend on such products.

"Quality, price, delivery" is a simple concept that is very difficult for a developing country to ingrain into the attitudes of its manufacturers, especially when they must make due with outdated, sometimes primitive, factories and equipment, often uncertain supplies of raw materials, and an oversubscribed transport system, all of which are improving only slowly. In the sample of US companies surveyed, only half as many were in China to buy as were there to sell. The proportion will change in favor of the buyers, who will continue to switch to China from other Asian suppliers, but it will take time. As manufacturing logistical problems are solved, China's abundant supply of cheap labor should provide a competitive edge in many common consumer products for a long time to come.

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[5] Ren Min Ri Bao, February 11, 1981, p. 1.
[6] Ren Min Ri Bao, December 9, 1980, p. 1.

Quality

Under the Four Modernizations China is trying to raise the value of exportable manufactured goods, including consumer durables, a category receiving increased emphasis since Readjustment. Foreign trade corporations are anxious to maintain a high level of quality to build a good name for products made in China. It is an admirable goal, but the country excludes itself, for the most part, from a sizable proportion of the US market that demands cheap, low quality merchandise. At the same time, Chinese products cannot bring the high prices that products "Made in USA" or long established foreign manufacturers command because of name-brand appeal. Due to self imposed quality limits on the low end by China and perceived quality limits on the high end by the US consumer, China can compete only in a narrow band in the middle. For example, Tianjin produces good stainless steel flatware, and cheaply, but it is too good to be priced with the low end flatware coming from Latin America (the type of knives and forks an all night diner doesn't miss when stolen), and not good enough to be priced with the excellent stainless flatware from Japan which is still reasonably priced.

The most important quality consideration in China at present is not a specific level, but that product quality remain consistent at the chosen level. Buyers simply will not come back if later shipments of goods begin to decline in quality. Over-promising by trade corporations as to quantity and delivery dates can lead to a decline in quality of product as small factories eschew previous high standards to meet an unreasonable quota. Buyers in China should know the capacity of the factory at which the goods are being made.

Price

Further complicating the problem of China entering the US market is the competition from other countries, particularly in Asia. To compete with Taiwan, Hong Kong, South Korea, or Singapore, China must provide the same quality product at a substantially lower price to entice buyers to switch from established suppliers. A rain umbrella selling for five dollars retail in K Mart may only earn the Chinese ten dollars a dozen delivered to a US Port. Painful as it might be, China has to become accustomed to the fact that imported consumer goods rise in price three to five times or more from US port to retail stores. As wages increase in wealthier Asia, developing countries such as Pakistan, given the industrial ability, will cut labor costs mercilessly and ever wait in the wings as China's future competition for the great American consumer market.

Many items of light manufacture, ideal for China's level of technology, are imported duty free into the US under the General System of Preferences of the US Tarrif Schedules when manufactured by China's four main Asian competitors mentioned above. China enjoys no such tariff privileges, and therefore must hold prices down by an even wider margin to be able to compete. It is possible for China to enter with a better product at an equal price, but US buyers are mostly looking for lower prices. For example, tool exporters in Shanghai obtained an automobile floor jack made in Taiwan and had machinists in an airplane factory copy it. The Taiwan jack had a cheap appearance and even leaked a bit, but it sold to the US homeowner who didn't need industrial quality. The Chinese copy was made with aircraft hydraulics, would lift twice the weight, but it also had the homeowner-use appearance. It was something in between what a private individual needed and what a service station would need. The Chinese were unwilling to sell at the same price at which the Taiwan jack sold, and consequantly did not sell their jack.

The price problem for China is compounded because of the limited availability of certain materials in the country. Any product requiring a substantial proportion of wood or cow leather, for example, poses a set of supply problems more easily solved by neighboring countries. Plastics in their many forms have enabled the world to produce cheaply items such as appliances, cookware, toys—the list is long—and yet, in China plastic is still expensive. China's ability to make plastic objects bright and colorful, or simulate another material is still below other Asian countries' standards.

Related to plastic is packaging. Many US buyers are still avoiding the China market because they cannot get the products shipped in a skin pack or blister pack to be hung on the myriad hooks lining the aisles of our retail stores. Coordinating several products, such as handtools, to be packaged with identical logos and colors thus completing a full program to be sold in a chain of US stores, when each item is made in a different factory sometimes provinces apart, can be daunting to say the least, especially when it can be done cheaply and quickly in a neighboring country.

Delivery

Prompt delivery should probably head the list of priorities for improving purchases by US firms. Because other Asian suppliers offer timely, reliable delivery schedules and have proven track records, China has to sacrifice heavily in price to get the buyer to switch sources and risk later delivery. As it is now, the delivery dates to which Chinese trade corporations will agree are usually longer than can be gotten in Taiwan, for instance. Late delivery on seasonal items like woodstoves or artificial Christmas trees can make losers of everybody in the US distribution network—importer, distributor, dealer, retailer.

Due to the bureaucratic nature of China's commercial sector, too often once the product leaves the factory the delivery problem becomes someone else's, and though reorders depend upon timely delivery, the factory manager has little or no control over the last vital leg of the contract. A fact of life in China is that even if the commercial sector operated with perfect dispatch, the physical limits of the transportation system would make it seem slow and inefficient. All the transport links, road, rail, port, are usually strained to capacity.

V. U.S. Trading Companies

As diminutive and sometimes inept as US trading companies are, the response by America's largest industrial corporations concerning their effectiveness in China (Question 6) was mostly positive. Of the US firms expressing an opinion, 50 percent more agree, than do not, that trading companies provide a useful service in China.

Most US companies, even the largest, cannot justify an internal department devoted solely to China. The business volume is not there yet. During the rush to China some US firms spent lavishly with little promise of a payback. Maintaining an office in Peking and the people to support it becomes a financial burden as negotiations drag on for months into years. Following the disappointing American Technology exhibition in Peking in late 1980, the US Under Secretary of Commerce warned in a Wall Street Journal article, "The time and expense required to crack the China market could turn away American companies." Indeed subsequently large companies such as Bechtel and Caterpiller did reduce their presence in China.

We can compete more efficiently, and therefore more effectively, with Japan and Europe in China, particularly in selling manufactured goods and technology, by pooling efforts. Employing a trading company to represent, provide feedback, assess market opportunities, etc. is a form of pooling that may keep expenses at a reasonable level while a US Firm "cracks the China market". The power of a Mitsubishi or a C. Itoh is derived from its information network and ability to respond to new market conditions by lining up producers, buyers, transport, and banking virtually over night. Information can be very expensive in a country like China where barriers to trade such as language, distance, and government regulation are magnified.

As US foreign trade continues to expand (exports as a percentage of GNP rose from 2 percent in 1972 to 8 percent in 1981) trading companies will proliferate. They will get better at what they do, although they will continue to be restrained by antitrust laws. The current relationship between government and business in America makes unthinkable, for example, several engineering firms cooperating to design and sell petrochemcial complexes to developing countries, backed by low interest government financing. US foreign trade cartels are illegal, yet we face this type of competition in China from Japan and Europe. As long as horizontal and vertical intergration of industry in the foreign arena remain illegal, and there are arguments that it should, US trading companies will stay small, providing services where they can but not really getting into the same ball game with Japanese trading companies, the ten largest of which account for over half of Japan's foreign trade volume.

IV. CONCLUSIONS

The honeymoon is over for US firms in China, and more normal business practices now are likely to prevail, meaning firms will watch closely the costs versus benefits of doing business there. A mean expected payback period of six years for investing efforts in China, and a nine year history of American commercial involvement indicates that many US firms can now make a solid evaluation of the China market based upon real experience. Surges in the economy such as the Four Modernizations and ebbs such as Readjustment are probably more closely related to an investment cycle, than to political storms, and if treated as such in conjunction with obtaining normal business guarantees, watching debt-service ratios, and so forth, can be weathererd by the US firms with an interest in China.

Success of US firms selling to China will go hand in hand with those firms that want to buy. China will spend dollars for US products when she has them, as the present lopsided trade balance indicates, but the rate of growth depends upon how fast China can earn dollars. China has basic industrial strength, a cheap but educated labor force, and the willingness to produce for the US. The catalyst that is needed to solve the time consuming problems such as packaging, product design, manufacturer's liability, delivery, is American ingenuity. The reward is a comparable or better product at a better price. The main competitors with products made in China will not be products made in the US. The competing products come from industrial Asia, where wages and prices are on the rise.

Beneath the present rhetoric in the West about the damages of Readjustment runs a belief that the China market is beginning to be, and will remain for a long time to come, an important consideration in the plans of US businessmen. Solutions to frustrating problems and a good part of the American ingenuity mentioned above will likely come from US trading companies, which through a diversification of activities are better able to cope with the sometimes speculative, sometimes long-run nature of the China market.

APPENDIX

BRIEF COMMENTS FROM THE MAJOR US FIRMS IN THE PRC TRADE

"Impossible to plan your market penetration with the vagaries of the PRC readjustment."

"Several projects underway—limited results to date, a hard market to work in. Prospects are long range."

"China market should be recognized as a long term investment, not to expect much return in the foreseeable future. To develop any trading opportunity with China following the Four Modernizations requires a lot of education, learning and definite guideline on 'priorities' by both parties of trade. Unless we understand China thoroughly, we would never be satisfied with the effort."

"Confusion between ministries—very, very slow progress and difficulty understanding business methods."

"Difficult negotiations; often unreasonable demands on our services; generally able to reach accommodation without problem growing unmanagable. We are satisfied."

"In state of confusion at this moment."

"When approached in a realistic manner the results can be very satisfying. Too many other companies just dived into it almost blind!!"

"Satisfied, will continue emphasis."

"They move very slowly. Small consuming public—gov't as opposed to populace."

"I feel the problems China has encountered, considering their rate of expansion, is understandable. Am looking favorably toward future growth and greater access to domestic market."

"The Chinese are spending their money carefully—fortunately we are in a high priority market. They are less sophisticated buyers than other countries. We are satisfied with the results our efforts have produced."

"At the moment most projects are on 'hold', but I expect this will change by the 4th quarter."

"Big, complex, potential high, but slow moving and unpredictable."

"Things move to slowly."

"China-related business will be slow in coming for the next five or six years. Companies now thinking of China as a market are retrenching. We are still in, but are internally prepared for a longer term return on investment."

"Our experience in dealing with China has been very satisfactory. The prospect of our future business in China will depend on the rate of economic development."

"It's like all other developing countries, very naive, ignorant of the outside world, looking for a free lunch—have a long hard struggle ahead and if you are going to work with them, you must have patience."

"It takes patience, commitment, and understanding."

"Generally satisfied, but sales activity should be higher. We're employing Chinese strategy of patience, looking to long term."

"We have no difficulty with exports, which are profitable and growing reasonably well. Exploration of possible local investments has not been encouraging."

"We have moved gradually and are satisfied with results. We find PRC buyers to be very insistent on low prices, but honor commitments once made."

"The market is developing very slowly due to lack of hard currency."

"We have experienced one major order and were satisfied with the Chinese we dealt with. The results were mutually satisfactory."

"Long range prospects excellent."

"Chinese believe that 'know how' should be sold at a very small profit. Foreign companies are giving products away and this sets a difficult precedent for others trying to make money."

"The delicate balance of pause in the heavy industrial sector and acceleration in the light industrial sector must be well understood by the West during the Readjustment period, which may last for another five years."

"They are unrealistic in their own evaluation of their importance as a market and do not have proper understanding of international marketing practices, although this should come with time. They are 'Takers', not 'Givers'."

"The current economic conditions and policies of the PRC do not create a good market."

"Market is difficult to penetrate and the use of traders appears to be the most successful at this time. Financing of imports through letters of credit is very time consuming. Until business volume warrents placing a representative within China, little improvement is anticipated."

"Sources of satisfaction: a potentially large market; a general willingness on the part of the PRC to cooperate in developing the market within local constraints; fair and equitable approach. Sources of dissatisfaction: language barriers and travel arrangements to the mainland; cost and effort involved in developing business opportunities; slow progress in development and implementation of policies covering joint ventures."

"Lack of laws and regulations on joint ventures, company law, etc. hamper negotiations. In addition, layers of bureaucracy also impede negotiations."

"Dissatisfaction due to problems associated with poor technical level of equipment operators and poor environmental conditions resulting in much higher than expected service and maintenance costs. Also, difficulty in negotiating with foreign trade corporations to obtain prices sufficient to cover increased cost of doing business in China."

"About as we expected."

OVERCOMING HINDRANCES AND IMPEDIMENTS IN UNITED STATES-CHINESE COMMERCIAL NEGOTIATIONS: THE EXPERIENCE OF THE CONTROL DATA CORPORATION

By John W. De Pauw*

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I. INTRODUCTION

As the current volume attests, much has been written about the history and activity surrounding United States-Chinese trade. Little, however, of a systematic and scholarly nature has been published about the process of negotiating with Chinese trade officialdom. The objective of this paper will be to examine what impediments—governmental or nongovernmental, United States or Chinese—are faced by United States firms undertaking commercial negotiations with the Chinese government.[1]

The experience of one U.S. company—Control Data Corporation (CDC) of Minneapolis, Minnesota—will be used to highlight commonality of interest and other key elements of U.S.-Chinese commercial negotiations. Specifically discussed are the CDC negotiations between 1973 and 1978 for the sale of equipment for seismic data processing centers to China.

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*U.S. International Trade Commission.

[1] The material for this paper has been largely drawn from chapter five of the author's book, "U.S.-Chinese Trade Negotiations," (New York: Praeger, 1981). The paper has also drawn on interviews by the author obtained subsequent to the publication of the book. Grateful acknowledgement of help, assistance and encouragement are due: Hugh P. Donaghue, Control Data Corporation; Catherine Bedell, former Commissioner, U.S. International Trade Commission; and Jon Holstine, National War College faculty.

The CDC contractual negotiations are important because they represent the sale of significant high-technology items to China and also because by themselves they represent, in dollar terms, a significant share of the total trade turnover for the years in which the transactions occurred. The CDC negotiations are also important, especially in the case of the first transaction, because they illustrate the frustration, "political maneuvering and sometimes sheer lunacy"[2] that may characterize commercial negotiations with any country.

For purposes of this discussion, commonality of interest is the maximization of any and all opportunities for compromise during commercial negotiations. Such compromise can result in the elimination of specific hindrances and impediments that could have delayed or thwarted commercial negotiations. Thus, commonality of interest, or its absence, can affect U.S.-Chinese commercial negotiations and, therefore, like the bureaucratic context that also influences these negotiations, can ultimately contribute to their success or failure.

In a larger context, commonality of interest can also imply a basic, almost urgent, need by the Chinese for the U.S. firm's product, a need so strong that it is almost mandatory that they secure the product from the U.S. firm, assuming successful negotiations. Such instances are rare but have occurred, as in the case of the sale by International Harvester Corporation of its airplane tow trucks.[3] Unfortunately, products made by CDC, while unique and needed by the Chinese, are not without competition.

II. The Chinese Need for Computers

One of the "clinchers" in the CDC sale of computers to China is that the latter wanted the CDC system "quite badly."[4] In fact, China has relied heavily on imports of computers, purchasing about 16 different computers from 1964 to 1975 (see Table 1). Ten of these were primarily parts of seismic or geophysical exploration systems of the type marketed by CDC.

TABLE 1.—TYPICAL SALES OF COMPUTERS TO CHINA, 1964–77

Year and type of computer	Supplier, country, and order value
1964: Unidentified	SERCEL, France; seismic exploration system.
1965:	
ARCH 1000	Marconi-Eiliott, United Kingdom; process-control system.
NADAC 100 (5 units)	SEA, France; plant automation systems.
1966: Elliot 803	Elliot Computers, United Kingdom; medical research use.

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[2] Hugh Donaghue, "Overview" (Washington, D.C.: Control Data, 1979), p. 1.

[3] In the case of Clark Equipment Company, Buchanan, Michigan (a subsidiary of International Harvester Corporation), the commercial transaction was completed in 65 days. Following major airplane purchases from Boeing and British Aircraft, the Chinese FTC, Machimpex, cabled Clark on February 19, 1973, asking for information relating to c.i.f. or c. & f. delivery for a single unit of Clark's model CT50E towing tractor. The company responded immediately with a price. Machimpex then requested a discounted price for 20 tractors. On March 30, Clark cabled an answer and asked for a letter confirming the sale. On April 2, Machimpex cabled confirmation and sent a confirmation letter 11 days later, thus ordering $150,000 worth of equipment without ever having met representatives of the seller face to face. In short, where there is a need by the Chinese for a product and no apparent direct competition, it is the U.S. firm that can afford to wait.

[4] Donaghue, "Overview," p. 7. Also see R. K. Nelson, "China Briefing: Chinese Electronic Society Visit to CDC, October 23 and 24, 1973," Minneapolis, October 15, 1973, p. 18.

TABLE 1.—TYPICAL SALES OF COMPUTERS TO CHINA, 1964-77—Continued

Year and type of computer	Supplier, country, and order value
1967:	
ICL 1903	ICL, United Kingdom; unknown destination.
ICL 1905	
1973:	
Univac	SERCEL, France; seismic research system.
Raytheon 704	Geospace, United States; seismic control, $5.5 million.
1974:	
Iris 60, Mitra 16 (2)	SERCEL, France; oil-exploitation management.
CDC 172 (2), CDC 170	CGG, France; oil-exploration ship, equipment $5 million.
1975: Interdata	United States; oil-exploration system, $23 million.
1976:	
Mitra 30	CII, France.
Burroughs B7700	Burroughs, United States; license denied.
RIAD EC-1040	East Germany; reported 1 installation in China.
HITAC M 160-2	Hitachi, Japan; Central Meteorological Office.
HITAC M 170	
Unidentified	Hungary; petroleum-control system.
Mitra 125 (2)	SFIM-CII, France; civil aviation use in China.
PDP 11/45 (2)	Digital Resources, United States; seismic exploration.
1977:	
Unidata 7738	Seimens, West Germany; power-station use.
IBM 3032	United States; for Bank of China in Hong Kong, $20 million.
IBM 360	United States; process-control application.

Source: Bohdan O. Szuprowicz and Maria R. Szuprowicz, "Doing Business With the People's Republic of China" (New York: John Wiley & Sons, 1978), p. 272.

Moreover, as will be shown below, the CDC computer systems are products necessary to the fulfillment of the Chinese plan—and, perhaps even more important, necessary in earning the foreign exchange necessary to finance imports. Of late, China has emphasized the three "balances" that must be maintained for successful commercial relations and trade.[5] First of all, it is important to strike a balance between imported projects and domestic capacity for economic development.[6] Just as important is the balance between imported technology and the national capacity to assimilate it. Finally, and perhaps most important, the Chinese believe it is important to maintain the "import-export balance." Thus, any U.S. company doing business with the Chinese is confronted at the outset by a very real policy that militates against frivolous utilization of scarce foreign exchange.

Since 1971 CDC has been actively interested in marketing computers to China to complement its sales of computers in other parts of the world. In 1978 CDC had world mainframe computer sales that constituted about 6 percent of the total world mainframe computer market. The company reported consolidated net earnings of $124.2 million in 1979, with earnings from the computer part of the business amounting to $70.8 million, 57 percent of the total. Total assets employed by CDC in 1979 were over $6 billion.[7]

CDC has become the world's largest computer services firm through the combination of its Cybernet services network and the acquisition of the Service Bureau Company (SBC—formerly owned by IBM) and, more recently, other international computer services enterprises. SBC's strength lies in commercial rather than scientific computing, providing a complement to the primary emphasis of Cybernet.

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[5] One observer, emphasizing China's limited capacity to absorb new technology, noted that "China is still 85 percent rural, and it can't be converted overnight to an industrial society." "A China Connection for U.S. Companies," New York Times, February 26, 1978, p. 2.

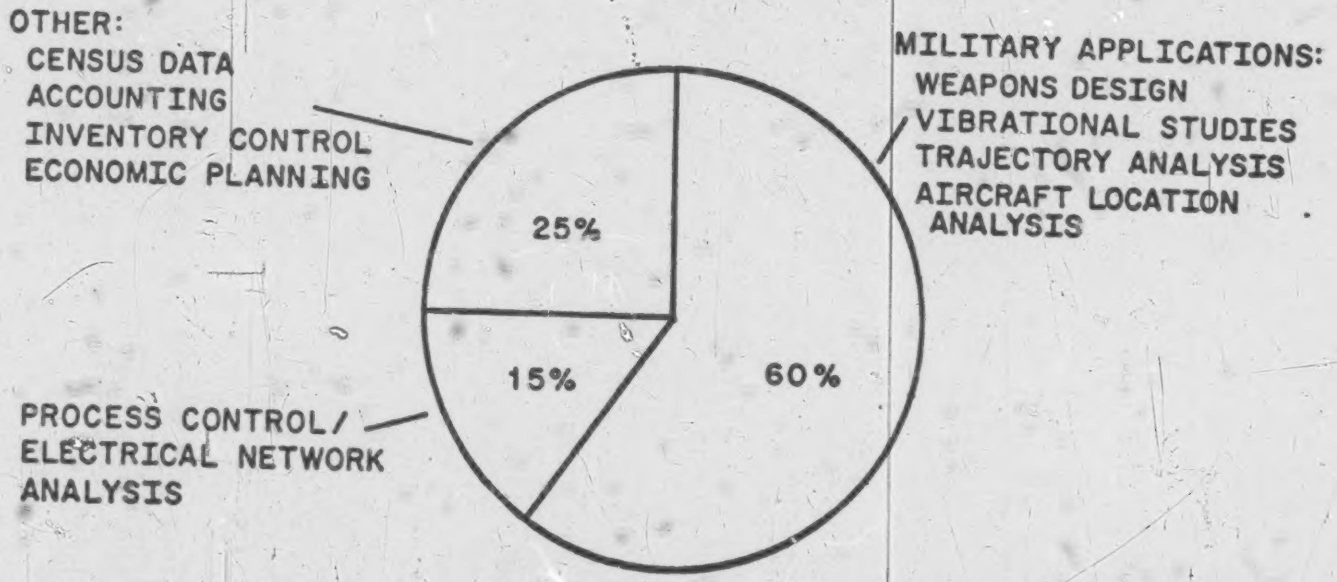
[6] Ibid.

[7] Control Data Corporation, Annual Report 1979, (Minneapolis, Minn.: Control Data, 1979).

In recent years a shift in the primary use of computers by China appears to have taken place. Most noticeable, and of particular importance from CDC's point of view, is China's demand for computers with specific applications, particularly in petroleum exploration. As shown in Figure 1, a significant percentage of computers imported by the Chinese have been for process control at imported turnkey plants or for end uses for which domestic computers are not available, such as analyses of weather data, management of banking operations, and air traffic control.

FIGURE 1

PRC Use of Computers



Note: Bohdan Szuprowicz, "CDC's China Sale Soon Focusing Western Attention," Computerworld, November 1976, p. 34, suggests that "at least 50 percent of all computers made in China are used for military applications such as nuclear and missile programs and in weapons systems design and shipbuilding."

Source: Control Data Corporation.

In its "China Briefing" (October 1973) CDC highlighted the observations of a group of six U.S. computer scientists who had written a report on the state of the Chinese computer industry. These observations are relevant today. According to their report:

> There is very little meaningful crystal ball gazing we can do about the future of Chinese computing, yet a few remarks in this vein seem in place. First, the Chinese we talked to indicated a strong interest in what they called the "super computer"—i.e., very big and very fast machines such as the CDC STAR computer and the Burroughs B6700. One guesses they will continue the trend toward bigger and faster computers, perhaps next attempting a very large step.[8]

An article in a Chinese economic journal in March 1979 also emphasizes China's need for computers. The author suggests that "the level of electronics [in a country] is an important indicator of modernization," and cites as one example of the current state of the level of the Chinese electronics industry the fact that "The Ministry of Foreign Trade can complete within one minute monetary transaction tasks with the offices it maintains in London and Tokyo and can query the computer center through the terminals for data."[9] The author then suggests that it is important for a developing country such as China to secure high-speed, quality data-handling computers as well as the adjunct peripheral equipment. However, one computer does not make an electronics industry, nor does it testify to a nation's capabilities in electronics. He notes:

> Under the guidance of Marxism-Leninism and Mao Zedong thought, using national economic plans as the criteria, and on the foundation of mass bookkeeping, our nation's socialist accounting work is destined to become advanced. But owing to the destruction and interference of Lin Biao and the "gang of four," it still lags rather far behind the advanced levels of the rest of the world in the use of electronic technology. Recognition of backwardness leads to the abolition of backwardness and an overtaking of the advanced countries.[10]

China's plan for the development of its computer science in 1978-86 was outlined in a major speech by Fang Yi, vice-premier of the PRC State Council, on March 18, 1978, at China's National Science Conference. Specifically, China should manufacture giant computers, as well as putting a range of computers into serial production. By 1985, according to Fang Yi, China should "have acquired a group of comparatively advanced specialists in computer science research and . . . to have built a fair-sized modern computer industry."[11] In short, the implication is that China needs computers and computer technology to become a modern developed state.

Fang Yi also noted:

> In the next three years we should rapidly develop basic research on computer science and related disciplines, lose no time in solving the scientific and technical problems in the industrial production of large-scale integrated circuits, and make a breakthrough in the technology of ultra large-scale integrated circuits.[12]

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[8] Nelson, "China Briefing," p. 18; "Computing in China: A Travel Report," Science 182 (October 12, 1972): 140.

[9] U.S., Joint Publications Research, "Applications of Electronic Computers to Accounting," "China Report—Economic Affairs," No. 7 (Washington, D.C.: Foreign Broadcast Information Service, August 14, 1979).

[10] Ibid.

[11] "China's New Priorities for Technology Development," China Business Review, May-June 1978, p. 6.

[12] Ibid.

Parenthetically, the fact that Fang Yi noted that China must "make a breakthrough in the LSI [large-scale integrated circuit] technology" may indicate a backwardness in such advanced technology that would put China a number of years behind the United States. This lag is noted in the report of a visiting U.S. Institute of Electrical and Electronic Engineers delegation in the fall of 1979. According to the head of the delegation, Chinese computer development lags at least ten years behind the West. Moreover, the PRC cannot catch up without outside help.[13] Thus, a market of great potential in fourth-generation computers for U.S. firms could exist. In this regard, according to Fang Yi, China would aim "to 'popularize' microcomputers and 'to put into operation' giant ultra-high-speed computers."

China's electronics industry is known to have the following five groups: components, instruments, computers, communications, and consumer products. Overall there are at least 200 major plants, 500 smaller plants, and 1,500 "neighborhood" factories. The Fourth Ministry of Machine Building has overall jurisdiction over the planning and production of electronic components and computer systems.

As of January 1980, China was believed to have more than 50 different models of foreign computers installed, with a total inventory of about 1,000 units.[14] Many of these units—perhaps about 20 percent of the total—are relatively small and slow, almost obsolete, machines. By contrast, about 170,000 general-purpose computers, excluding minicomputers, are believed to be in operation in the United States, and about 12,500 in the civilian sector of the Soviet Union.

Thus, even before entering negotiations, CDC's bargaining position was quite advantageous. This was particularly true because mainframe computers had high priority in Chinese import planning, if only for "prototype purchasing." Consequently, scarce foreign exchange was most likely to be allocated for purchase of these products. Conversely, if CDC's product had not had high priority in Chinese import planning, the company's bargaining position would have been a relatively weak one; although its products might not have been rejected out of hand, pressures for countertrade at the very least would have been quite strong.

III. CDC CORPORATE STRATEGIES

CDC's initial strategy in 1971/72 can be summarized as follows: to assess China as a viable market for the future; to determine the political climate for business; to get China acquainted with CDC.[15] As early as June 1971, a CDC memorandum suggested that

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[13] "China 10 Years Behind in Computers, U.S. Professor Says," Electronic News, January 21, 1980, p. 1. Also see report of Japanese mission in 1979: John Hataye, "Find China Plants Years Behind West," Electronic News, July 30, 1979, p. 1.

[14] Bohdan O. Szuprowicz and Maria R. Szuprowicz, "Doing Business with the People's Republic of China, Industries and Markets" (New York: John Wiley and Sons, 1979), p. 263. Also see Control Data Corporation, "Trip Report" (Minneapolis, January 2, 1980), p. 2; David C. Bowie, "The Electronics and Computer Establishment in the People's Republic of China," (Washington, D.C.: Trade Development Assistance Division, Bureau of East-West Trade, U.S. Department of Commerce, January 1980), p. 3.

[15] Interview with Hugh Donaghue, March 1980.

"we, just as our competitors must be doing, should develop a plan for eventually marketing selected lines of our computers in China." [16] The memorandum thought it "highly probable" that the U.S. government would allow selected exports of certain mainframe computers. Moreover, it was "more than likely," according to the memorandum, that China would import rather than manufacture its own computers "for the foreseeable future."

Considering this optimistic assessment of the market for computers in China, CDC's corporate staff was faced with the immediate question of how to proceed. The 1971 memorandum referred to above suggested two courses of action that occupied the CDC corporate staff for the next two years. These centered on establishing marketing contacts through Canadian and/or Hong Kong channels. Like any company beginning a new venture, CDC was in many respects "flying blind." A 1974 CDC memorandum highlights this particular aspect:

> I am quite certain an American could not get a visa to visit there at the present time, but a Canadian could. We'd start by writing a few letters through Hong Kong and state the purpose of the proposed visit. Who knows, maybe we'll get a hit that could lead to something.[17]

In light of its market assessments and in order to facilitate marketing strategies and to pool information, CDC established a corporate "task force" in September 1973. Communication among the members of the company's China task force and with the company as a whole was a prime item on the agenda, as was outlining the requisite "position papers" to be prepared on "major corporate product strategies for China." [18] The marketing strategy adopted was to sell the "entire range of total services and to engage in appropriate cooperative activities with the PRC." [19] In December 1973 a CDC memorandum suggested:

> This marketplace for U.S. high technology, and in particular computer and telecommunications technology, is developing in a quantum jump that is much faster than . . . many experienced China-watchers had anticipated seven months ago. The tremendous opportunity this gives Control Data is exciting to witness.[20]

Moreover, according to the CDC memorandum:

> In the increasingly relaxed U.S.-China political climate, China would be looking toward U.S. technology to speed modern industrial development, which, in 1973, has resulted in an absolutely astounding record of 20–25 complete U.S. large plant sales valued at between $1.0–$1.5 billion.[21]

Notice the continuing CDC emphasis on the political situation in China. Doubtless the company was also buoyed by a joint U.S.-China communiqué released on December 5, 1973, following Secretary of State Henry Kissinger's sixth visit to Peking. According to the communiqué, "the Chinese and U.S. agreed to take steps to further trade relations." [22]

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[16] Control Data Corporation, "Interoffice Memorandum on Mainland China" (Minneapolis, June 24, 1971), p. 1.

[17] Ibid.

[18] Control Data Corporation, "Minutes of China Task Force Meeting" (Minneapolis, September 21, 1973), p. 1.

[19] Ibid.

[20] Control Data Corporation, "Interoffice Memorandum—China Office" (Minneapolis, December 7, 1973), p. 1.

[21] Ibid.

[22] Henry Kissinger, "White House Years" (Boston: Little, Brown, 1979), p. 1053.

A 1977 CDC market assessment is instructive for its insight into the strategies that the company debated and subsequently adopted. In assessing the potential market for computers CDC estimated that in 1977, China would need at least 5,000 computers for industrialization "in the near future."[23] According to company marketing experts, it was reasonable to assume that China was capable of producing about 150 computers a year, with a growing rate of about 25 percent per year. Therefore "the potential market for computers is in the order of at least 1,000 machines in the near future." In dollar terms, according to CDC expectations, this might amount to as much as $250 million.[24]

Moreover, CDC believed that the potential market for original equipment manufacturer's (OEM) peripherals also was promising, but did not estimate the dollar value that might be involved. China would be able to pay for this Western equipment "with increasingly larger amounts of oil."[25] It was this optimistic assessment of the market in China that spurred CDC to approach the marketing of its computers with vigor.

On the basis of this assessment, CDC's objectives in the short run were to pursue immediate prospects, particularly with regard to selling OEM disk drives and tape drives, and to pursue contact and possibilities with China's Academy of Sciences. CDC's long-range plans were much more ambitious, including such projects as selling large systems for nuclear research and for use in the petroleum industry, education, and weather forecasting. Also included were the sales of licenses for peripheral equipment.

The major competition, according to CDC corporate strategists, was probably from such Japanese manufacturers as Hitachi, Fujitsu, NEC, Mitsubishi, and Toshiba. However, they saw Japan's computer industry as being "weak". in service and support of its customers." China, according to the plan, was an ideal customer because it neither required nor desired the normal computer sales support "beyond the initial training of its technicians."[26]

With regard to U.S. competition, IBM was without peer "because of its monopoly in the EDP field," according to CDC. CDC's marketing plan, however, suggested that although IBM is strong in some areas, and although the Chinese have made extensive studies of IBM equipment, "IBM does not provide as good a price or performance as CDC in scientific or educational environments."

The company's strategy therefore became a twofold one of "pursuing immediate prospects" and of "further improving relationships with Chinese foreign trade corporations." The first move would yield immediate revenue, according to the plan, while the second one would, it was hoped, lead to "future sales, technical sales and joint ventures." Just how successful these CDC corporate strategies proved to be will be discussed below.

As a means of implementing its sales strategies, the company in September 1973 replaced its China "task force" with a corporate China office. The new office was to participate directly in the development and implementation of CDC's strategy for marketing computers to the Chinese. Such participation would include long-range planning and assistance to the International Development Committee, the Management Committee and other members of top management.[27] According to the company's job description, the person in charge of the office would be an assistant to the executive vice-president and would report to the executive vice-president and chairman of the International Development Committee. Other duties would include the following:

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[23] Control Data Corporation, "Marketing Plan for China" (Minneapolis, June 6, 1977), p. 5.
[24] Ibid.
[25] Ibid., p. 7.
[26] Ibid.

> Developing contacts and liaison at the highest levels of PRC government and embassies, China Academy of Science, Ministry of Foreign Trade, and selected Chinese Foreign Trade Corporations (FTC).[28]

The new office also would cooperate closely with U.S. officials at the Department of State, Department of Commerce, National Academy of Science, and other agencies. It was particularly charged with "keeping abreast of social, political and economic factors as they relate to the evolving corporate strategy for the PRC." In establishing a new China office, CDC was clearly making a commitment to the future: "It is important that we maintain an image which indicates that [we] . . . are interested in building a long term relationship with China, rather than an image of a company which only reacts to their immediate requirements."[29]

IV. FIRST CONTACTS

Establishing contact with Chinese foreign trade organizations (FTO's) and end users is a major obstacle in undertaking commercial negotiations for most U.S. firms. CDC realized from the beginning that commercial negotiation involved much more than sitting down at a table, offering a product, and determining a price. For entry into the China market, it was first necessary to find in the Chinese foreign trade labyrinth the right person or organization to market the product—in other words, to make contact with the end user. For CDC, establishing first contacts with the Chinese was particularly difficult.

The company first became interested in the PRC as a potential market about the time of United States rapproachement with China in 1971-72.[30] The first CDC contact was a proposal sent July 16, 1971, to the Chinese Ministry of Science and Technology via the Chinese Embassy in Ottawa.[31] In essence the proposal offered to export to a Canadian firm certified CDC peripherals and mainframes that were "refurbished and modified as appropriate."[32] The CDC corporate staff also learned at this time from the president of another U.S. firm that China found it "more politically desirable" to deal with Canada than either the United States or Japan. In addition the CDC contact mentioned that "presumably,

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[27] Control Data Corporation, "Charter for Embryonic China Office" (Minneapolis, September 6, 1973).

[28] Ibid.

[29] Control Data Corporation, "Marketing Plan," p. 9.

[30] Control Data Corporation, "CDC Contracts with the People's Republic of China to Date" (Minneapolis, September 6, 1973), p. 2.

[31] Ibid.

[32] Control Data Corporation, "Interoffice Memorandum on Mainland China," p. 1. Also see Control Data Corporation, "Interoffice Memorandum—Ministry of Science and Technology" (Minneapolis, September 2, 1971), p. 1.

France would also be relatively high on the Chinese acceptability list."[33] CDC later learned through contacts that the Canadian government believed a direct approach by CDC would be better.

As can be seen from another CDC memorandum, the corporate staff leaned also to the direct approach in contacting the Chinese. The staff's perception was as follows:

> One approach is through the foreign trade corporations (FTC's) which are controlled by the Ministry of Foreign Trade since foreign trade is a state monopoly * * *.
>
> The first step in establishing business contacts with the PRC is to select the appropriate FTC. It is best initially to contact the main office in Peking * * * although responsibility for the import or export of particular commodities is often delegated to various branch offices, and negotiations may ultimately be with them. Just as in East Europe, normally all negotiations are handled by the foreign trade officials—contact with end users is rare. PRC trade missions in foreign countries have been known to take the initiative in contacting Western firms when the Chinese have a strong interest in their products * * *.
>
> The initial proposal submitted to the appropriate FTC in Peking should be sufficiently detailed and comprehensive to allow the Chinese to evaluate it commercially. Price quotations are not recommended. However, full information about CDC, its activities and its products is essential. It is further recommended that the firm indicate a willingness to provide further details, answer any questions, and arrange personal follow-up meetings.[34]

CDC was convinced that all indications here pointed to computers being a high priority item on the Chinese shopping list, because a reply should be expected to a CDC proposal.

In order to begin the direct approach, CDC entered into an agreement in October 1971 with a Washington-based consulting firm that had good contacts with China Resources Company of Hong Kong as well as with Chinese officials in all parts of the government, for the purpose of "strengthening the company's position in dealing with officials of the PRC."[35] In fact, one of the principals in the firm was a former acquaintance of Premier Chou En-lai, and thus was in a position to be very helpful. According to the contract with CDC, the consultant

> * * * will assist CDC in analyzing the market potential for its products and services in the PRC; will accompany certain of the company's business and technical officials to the PRC to cooperate with and advise CDC in the detailed sales negotiations; will assist in the development of the finance package necessary to assure the success of the transaction; and will assist in obtaining export licenses in Washington, D.C.[36]

The CDC contract with the consultant lasted from October 1971 to June 1973. Although there is no clear evidence that the consultants were actually able to secure a contract for CDC, they were able to "open doors" to China and arrange contacts that might otherwise have eluded CDC.[37] One CDC official, commenting on the arrangement with the consultant, stated that "if this looks like a five-step process to get from CDC to the correct purchasing agency of goods and services in China, it is."[38]

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[33] Control Data Corporation, "Trading Companies" (Minneapolis, August 27, 1971), p. 2.

[34] Control Data Corporation, "Trade—People's Republic of China" (Minneapolis, July 22, 1971), pp. 1-2.

[35] Control Data Corporation, "Letter to Hugh F. Donaghue," April 18, 1973, p. 1.

[36] Control Data Corporation, "Consultation and Sales Agreement between PRC and Control Data Corporation" (Minneapolis, October 1, 1971), p. 2.

[37] Interview with Hugh Donaghue, February 1980.

[38] Control Data Corporation, "Trip Report" (Minneapolis, April 16, 1973), p. 1.

In December 1971 the consultant informed CDC that China was interested in buying computers through a barter arrangement.[39] According to the consultant:

> I think the best Christmas gift for me to give to you is to tell you: it is a deal. The [PRC] are going to buy your computers. The question not decided yet is: how many? This has to be determined by whether we ask for cash or accept their barter. As soon as I receive the catalogs, I will have them sent up north right away. Then I will sit down with them to discuss the nitty-gritty of barter. Perhaps they will buy more than just two 3600s at this time.[40]

During the next 6 to 8 months the CDC consultant had other meetings with China Resources, and in early September 1972 met with the deputy director of the National Machinery Import and Export Corporation. During this meeting they discussed the Chinese plan to acquire several computers and the possible method of payment.

CDC officials, however, were realistic in their assessment of the situation, for in a March 1972 memorandum the question of export licenses was raised—a question that was to come up many times during the lengthy course of the negotiations.

> The Chinese were not willing to give him a letter of intent unless he would give some assurance that a U.S. Government export license would be forthcoming. This is one of the reasons he returned to the U.S., in order to discuss the export problem with White House officials. As you may be aware, just prior to the President's trip to China he recategorized the People's Republic of China placing them in the same category as the USSR and East Europe. Therefore, [the consultant] . . . was given oral assurance that under the proper conditions we would get export approval for a 3600. He still has some concern as to whether the conditions will be palatable to the PRC.[41]

China Resources, Hong Kong's oldest and best-known agency representing Chinese state trading companies, is organized as shown in Figure 2. At the time China Resources had 11 Chinese partners, all of whom had addresses in Hong Kong.[42]

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[39] Control Data Corporation, "Letter from Consultant" (Minneapolis, April 19, 1971).

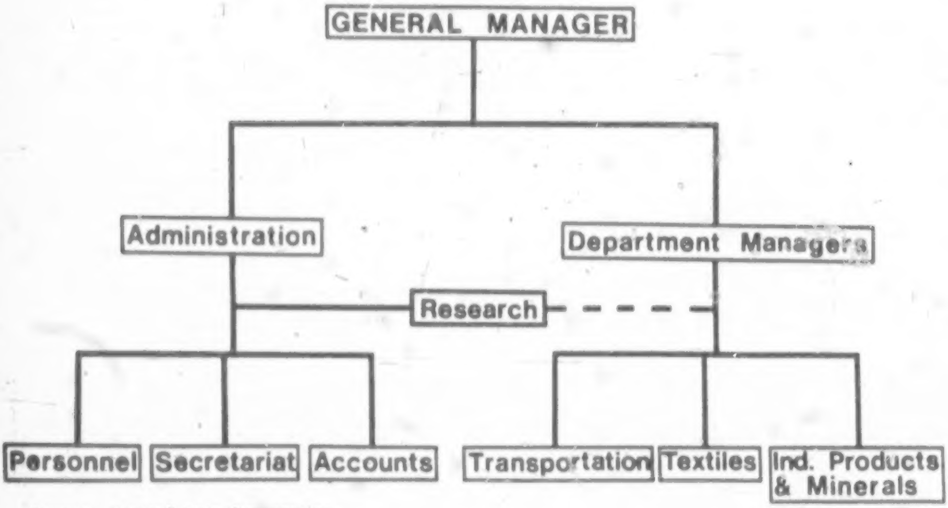
[40] Ibid.

[41] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, March 9, 1972), p. 2.

[42] Alan H. Smith, "Standard Form Contracts," International and Comparative Law Quarterly 21 (January 1972): 137. The legal ramifications of dealing with China Resources appear to be quite nebulous, according to Smith. Of interest is that the consultant submitted a price list for CDC computers to China Resources in Hong Kong in September, and when he arrived in Peking in early October, the price list was not yet available at the Peking office. This indicates less than speedy communications between China Resources and Peking.

FIGURE 2

China Resources Organization


GENERAL MANAGER
Administration
Department Managers
Research
Personnel
Secretariat
Accounts
Transportation
Textiles
Ind. Products & Minerals

Source: Control Data Corporation.

In November 1972 the consultant mentioned in a letter to CDC that during his recent month-and-a-half trip to China he was "given to understand that as soon as they have an opportunity to examine all the documents which Control Data submitted, they will notify Control Data about business discussions."[43]

Other CDC contacts with the Chinese were made during 1971-72, all with the basic purpose of getting the Chinese to know about CDC. For example, in April 1972, CDC sent a letter to the China National Machinery Import and Export Corporation telling about CDC and its personnel.[44] In their reply on June 15 the Chinese acknowledged receiving the brochures and other literature that were forwarded to them by China Resources. They also expressed interest in CDC's equipment and asked for a price list on typical configurations.[45] The fact that CDC's letter was answered directly by the Chinese was "a good sign" since apparently only about one out of every 50 or 60 corporate letters is answered directly by Peking.[46] Normally responses are channeled through organizations such as China Resources.

In September 1972, CDC sent a letter to China National Machinery Import and Export Corporation responding directly to the Chinese letter of June 15. In the letter the subject of prices for CDC computers was addressed:

> You will note that we have quoted prices for typical configurations of our Cyber 72, 73, and 74 computer systems. Various combinations can be developed depending upon the size of the memory, the number of central processing units, and various configurations of peripheral equipment. . . . Configurations vary depending on the needs of the customer and therefore, individual units may be added or taken away from each of these peripheral sets. In that case the price of the individual item is either added or subtracted from the total prices.[47]

With the letter CDC enclosed information on the pricing of software and guidance material to allow the Chinese "to configure their own computer systems."[48] Thus, the CDC letter constituted another element in that part of the familiar game of doing business—"getting to know you."

Still other CDC contacts with the Chinese during early 1971/72 included a meeting with Chinese officials in Bucharest, Romania, in April 1972 and an "exchange of business views with China Resources officials over dinner in Hong Kong in July."[49] The basic purpose of these far-flung contacts was to familiarize the appropriate end user with CDC computers.

Thus, in the development of computer sales, CDC was essentially attemping to gain contact with decision makers. The company's first real contact as a U.S. corporate entity with potential Chinese "buyers" of computers came in October 1973 with the visit to the United States of the Chinese Electronic Society. It was this visit that enabled CDC to gain a "jump on its other U.S. competitors."[50]

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[43] Control Data Corporation, "Letter from Consultant on China Trade" (Minneapolis, November 14, 1972), p. 1.

[44] Control Data Corporation, "CDC Contracts," pp. 2-3.

[45] Control Data Corporation, "Status Report" (Minneapolis, September 22, 1972), p. 1.

[46] Ibid. CDC learned this in subsequent talks with China Resources Personnel.

[47] Control Data Corporation, "Letter to Chinese Foreign Trade Corporation" (Minneapolis, September 13, 1972).

[48] Ibid.

[49] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, August 10, 1973), p. 1.

[50] Interview with Hugh Donaghue, March 1980.

The general purpose of the visit was to make a comprehensive study of U.S. electronic computers. It was a result of Henry Kissinger's visit in February 1972 to Peking, where, among other things, the exchange of scientific and technical groups between the United States and China was discussed.[51] The visit of the Chinese group also provided CDC with an opportunity to "convince the Chinese that CDC technology is and will continue to be state-of-the-art." [52]

The visit proceeded without problems, and in a follow-up letter in January 1974, CDC expressed its "appreciation" to the society for its visit. The letter went on to suggest "the establishment of a series of seminars on computer contacts at a location to be designated at your convenience." [53] The purpose of these seminars was to provide CDC and the Chinese with further opportunity to get to know each other.

V. THE FRENCH CONNECTION

Despite the efforts of CDC to establish contacts with Chinese end users and decision makers, perhaps the most important factor in securing substantive contact, and therefore substantive contractual negotiations, was the CDC decision to take a foreign partner in the sale: Compagnie Générale de Géophysique (CGG) jointly signed the contract with CDC's wholly owned subsidiary, Control Data France (CDF).[54] CGG was in the very early stages of responding to a proposal tendered in a letter by the China National Technical Import Corporation (Techimport). The proposal was for a data processing center to be installed at an unknown location along the Chinese coast to process the data of at least 15 land crews exploring for oil in the eastern sedimentary basins of China. Since 15 land crews exploring for oil were estimated to develop about 15,000 records per month, the high-sea exploration boats were developing an estimated 150,000 records per month, and the shallow-water boats 30,000 records, Techimport would need one or two Cyber 70 series central computers to process all of these records. The Chinese estimated that "the design of the equipment configuration will be 250,000 seismic records per month, within which one-fourth of the throughput of Machine II is for the disposition of other processing, one-fourth of the throughput is for the research of the new processing method." [55]

One of the basic assets of CGG was that the company had been selling oil exploration equipment to the Chinese for over ten years and had earned their respect. They were in a sense "old friends." CGG personnel in fact did much of the negotiating, particularly in the final commercial stages. Also, the Chinese insisted that CGG sign the contract along with CDF. Thus, in effect CGG was to be the prime contractor responsible for all of the special-applications software for the computer systems and for much of the software training. CDF was to be responsible for installation and warranty of the computer system.

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[51] Control Data Corporation, "Fact Sheet on the Computer Visiting Group from the People's Republic of China" (Minneapolis, September 26, 1973), p. 1.

[52] Control Data Corporation, "Minutes of Meeting" (Minneapolis, October 3, 1973), p. 2.

[53] Control Data Corporation, "Letter to Computer Visiting Group of the Chinese Electronics Society" (Minneapolis, January 25, 1974), p. 1.

[54] CGG and CDF are combined here to simplify the account of the negotiations.

[55] Control Data Corporation, "Letter to Control Data Corporation, Reference to Contract No. CF-7412" (Minneapolis, August 14, 1974), p. 1.

The Chinese proposal received by CGG in late February 1973 covered all kinds of equipment used for the acquisition and the processing of seismic data for offshore and onshore oil exploration.[56] CGG/CDF did not know at that time whether Techimport's letter was an inquiry or a request for a proposal. Therefore, in late May they couched their reply in such a way that it could be considered as a proposal.

In addition to the emphasis on lower price in their reply, also of importance was the company's statement that it was important to "establish contacts * * * *on a direct basis* [emphasis added] as it is unnecessary and often less efficient to work through intermediaries especially when dealing with friends." [57]

CGG/CDF's approach turned out to be the right one, since the Chinese suggested in mid-July that discussions begin as soon as possible; the first meeting took place on August 4 in Peking.[58] It was at once clear that Techimport considered CGG/CDF's answer as a proposal and that the immediate task of the sessions was to conduct technical negotiations. At the first meeting the Chinese indicated that they were interested in a medium-size processing computer as well as certain kinds of field equipment. Other points raised in subsequent technical negotiations on August 8 and August 13 were:

> The possibility to get a convolver or an array processor in due time.
> The balance of the possible configurations.
> The possibility to easily extend the configuration in the future.
> The capacity of the proposed systems.
> The easiness to adapt our software to the operating system of each computer.
> The technology of different computers.[59]

It is interesting to note that during the technical discussions Chinese specialists were convinced that IBM's computer technology was more advanced than that of CDC. Thus, the visit by the Chinese Electronic Society in October 1973 assumed all the more importance in light of the incipient technical negotiations between CGG/CDF and Techimport in which the Chinese were not knowledgeable about CDC.[60]

Such lack of knowledge about CDC was reemphasized during a discussion that a CDC official had in Washington, D.C., with the PRC that "although Mr. . . . had heard of IBM, he had not heard of CDC." [61] So CDC's negotiating problem in this instance was to persuade the Chinese technicians that CDC computer configurations could indeed compete with those of IBM.

During the negotiations the Chinese asked very detailed questions about the CDC computers. Detailed answers to the questions covered sessions on August 17, 18, and 20. Following the meeting on August 20 the chief Chinese negotiator said that commercial negotiations could be started earlier than anticipated and that CGG/

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[56] Ibid.

[57] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, May 19, 1973), p. 5.

[58] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, August 28, 1973), p. 2.

[59] Ibid.

[60] Control Data Corporation, "Trip Report to Washington, D.C." (Minneapolis, August 10, 1973), p. 1. Such lack of knowledge about CDC was rectified during the meeting.

[61] Ibid.

CDF would be advised when they would begin. The CGG/CDF negotiators concluded that it might be several months before negotiations might resume.

> According to our recent experience, confirmed by the tasks we had in the hotel at Peking with a lot of people of many companies and nations having outstanding business with Techimport, it has to be foreseen that technical and commercial discussions about a major computer could last from 8 to 10 weeks.[62]

But despite the anticipated delays the negotiators concluded "that CDC and CGG have a fair chance" of securing the contract. Chinese computer specialists who were very familiar with integrated circuits were concerned about the technology of the two proposed CDC Cyber 172 computers to be included in the processing-center transaction. At a meeting in Minneapolis on September 27, 1973, between CGG and CDC officials, the basic problem "of the need to convince the Chinese that CDC technology is and will continue to be state-of-the-art" was again highlighted.[63] It was agreed that during the visit of the Chinese Electronic Society in October 1973, the rationale for use of CDC technology would be covered.[64]

The CGG/CDF negotiators were correct. Negotiations were postponed until January 1974, while the Chinese made every effort to learn more about CDC's product. In fact, during January four Chinese geophysicists worked closely in Paris with CGG, and Cyber hardware and software presentations were made to them by CDF. Thus, in a CDC "Summary of China Progress to Date" at the end of 1973, company officials were convinced that "responsible Chinese in the computer industry know Control Data, its products and capabilities." [65] This conviction was the result of no small CDC effort. During the period from September 21, 1973, through March 1974, no fewer than 18 meetings were held in various parts of the world between CDC and various Chinese organizations, Chinese officials, and influential U.S. persons.[66]

The meeting between CDC Canada officials and the Chinese in February 1974 at Peking is illuminating. During one of the many sessions devoted to briefing Chinese technical personnel on CDC Cyber equipment, the Chinese stated that "all decisions were political *before* financial." [67] [Emphasis added.] Thus, this was but another round in the "getting to know CDC" scenarios.

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[62] Ibid.

[63] Control Data Corporation, "Interoffice Memorandum—Minutes of Meeting of CGG" (Minneapolis, September 27, 1973), p. 2.

[64] Ibid. During the September meeting with CDC, as an aside one of the CGG negotiators commented on the difference, based on his experience, between dealing with China and with the USSR. In his view, the Chinese are more serious in their business discussions, and more honorable. Henry Kissinger, in "The White House Years" (Boston: Little, Brown, 1979), makes similar perceptive comments regarding the Soviet and Chinese approaches to negotiations:

"The Soviets offer their goodwill as a prize for success in negotiations. The Chinese use friendship as a halter in advance of negotiation; by admitting the interlocutor to at least the appearance of personal intimacy, a subtle restraint is placed on the claims he can put forward . . . move from infallible dogma to unchangeable positions (however often they may modify them). Chinese, having been culturally preeminent in their part of the world for millennia, can even use self-criticism as a tool. The visitor is asked for advice—a gesture of humility eliciting sympathy and support. This pattern also serves to bring out the visitor's values and aims; he is thereby committed, for the Chinese later can (and often do) refer to his own recommendations. The Soviets, with all their stormy and occasionally duplicitous behavior, leave an impression of extraordinary psychological insecurity. The Chinese stress, because they believe in it, the uniqueness of Chinese values. Hence they convey an aura of imperviousness to pressure; indeed, they preempt pressure by implying that issues of principle are beyond discussion.

"In creating this relationship Chinese diplomats, at least in their encounters with us, proved meticulously reliable. They never stooped to petty maneuvers; they did not haggle; they reached their bottom line quickly, explained it reasonably, and defended it tenaciously. They stuck to the meaning as well as the spirit of their undertakings. As Chou was fond of saying 'Our word counts'." (p. 1056)

[65] Control Data Corporation, "Summary of China Progress to Date" (Minneapolis, December 31, 1973). p. 4.

[66] Ibid., pp. 1–3.

According to company "negotiating notes" in early 1974, there were four items of "concern":

Risk-of-loss clauses were to remain the same.

No concessions were to be made on benefits to on-site personnel. Also, the right to exchange them, if desired, was to be maintained.

No indirect damages were to be allowed.

Arbitration was acceptable in any country except China, France, Sweden, Switzerland. Moreover the law of the country should apply.

Payment terms were very explicit:

20 percent down;

20 percent on preacceptance test; remainder on delivery (negotiable: we will accept 10 percent down);

50 percent total before delivery; and

90 percent on delivery, final 10 percent on completion of acceptance.[68]

Moreover, the negotiators were to quote "standard CDC prices for hardware to China." They were instructed specifically that "they may not discount." However, 10 percent of the hardware price was "negotiating room" that included the fee to CGG, and "other free things."

The notes indicated that the Chinese might bring up questions concerning deferred payment and payments for training. The negotiators were instructed that deferred payments were acceptable if French government financing were available, otherwise not.

On the question of training costs, CDC would supply a rental car and $12 per diem for living expenses for the Chinese while in Minneapolis. The total would come to $35 per day.

VI. THE FINAL SIGNED CONTRACT

On August 14, 1974, some 18 months after receiving the Chinese proposal, a contract was signed between Techimport and CGG/CDF for the delivery of two Cyber 172 systems to the China National Oil and Gas Exploration and Development Corporation. The total value of the contract was approximately $6.8 million. At the time it was the largest contract signed between Techimport and a computer manufacturer.[69] It was a "turnkey" package for a large national seismic data processing center located in the Peking area. CGG/CDF, working as joint contractors, were to provide the following products and services:

Site planning, equipment, and engineering; training of 12 Chinese engineers during 7.5 months; two Cyber 172's and two system 17's; complete set of spare parts; and complete CGG seismic product set and special electronic equipment.

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[67] Control Data Corporation, "Interoffice Memorandum—Trip Report to the People's Republic of China, January 17, 1974" (Minneapolis, March 7, 1974), p. 2.

[68] Control Data Corporation, "Interoffice Memorandum—People's Republic of China-CGG Negotiation" (Minneapolis, February 20, 1974), p. 4.

[69] Control Data Corporation, "Seismic Contract with China" (Minneapolis, September 27, 1974), p. 1; "Interoffice Memorandum—Joint Contract with CGG in China" (Minneapolis, September 13, 1974), p. 4.

A complete listing of prices of these products and services is shown in Table 2. The purchase agreement essentially stipulated a 95 percent cash payment in U.S. dollars to CGG/CDF at the time of delivery, f.o.b. France, plus 5 percent after acceptance.

TABLE 2.—PRICES OF GOODS AND SERVICES SOLD TO TECHIMPORT BY CGG/CDF, 1974

Goods/services	List price		Discount price (U.S. dollars)
	French francs	U.S. dollars	
Cyber 172—4 seismic processing systems	22,708,955.00	4,682,258.76	4,260,855
System 17 seismic preprocessing system	2,396,960.00	494,218.56	499,739
Software of Cyber 170 and system 172	2,447,920.00	504,725.78	459,300
Interactive graphic system	426,000.00	87,835.05	79,930
Display equipments	1,409,825.00	290,685.57	264,524
Ancillary equipments	594,278.00	122,531.55	111,504
Site equipments	1,170,000.00	241,237.11	219,526
Consumables	1,371,550.00	282,793.81	257,342
Spare parts	2,872,013.81	592,167.82	538,873
Training and technical support	815,700.00	168,185.56	153,049
Total price of contract		7,466,639.57	
Total price after discount			6,844,642

Note: The conversion rate used in the contract was French francs 4.85 = U.S. $1.
Source: Control Data Corp.

The delivery of the Cyber equipment was planned for "not later than February 20,1976." Chapter 12 of the contract addressed force majeure contingencies as follows:

> If either of the contract parties is prevented from performing his contractual obligations after signing the contract due to war, serious fire, flood, earthquake, or some other causes agreed upon between both parties as cases of force majeure, the time for performance of the contract shall be extended by a period equivalent to the effect of such causes.[70]

Of interest is that in the event of the force majeure instances mentioned, "the time for performance of the contract shall be extended"; the contract would not be revoked. After stipulating procedures to be followed in force majeure cases, the contract stated—quite fortuitously, as it turned out:

> Should the effect of force majeure mentioned above last over 120 (one hundred and twenty) consecutive days, both parties shall *settle a procedure of executing the contract through amicable consultations as soon as possible.*[71] [Emphasis added.]

As it turned out, such "amicable consultations" were necessary because of difficulty in getting a U.S. export license.

VII. FOLLOW-ONS

Cyber System Contracts

Four years after the signing of the first contract, CDC, with CDF/CGG as a partner, signed contracts with the China National

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[70] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, September 17, 1978), p. 24. Also see Control Data Corporation, "Contract for Complete Equipment for Large Size Seismic Data Processing Centers, contract No. 78ME-45090F (1978)" (Minneapolis, December 22, 1978), p. 33. The language on Force majeure in both contracts is the same.

[71] Ibid.

Oil and Gas Exploration and Development Corporation for Cyber Systems equipment valued at $69.84 million. Table 3 summarizes these transactions. The contract for the ten Cyber 172s, a Cyber 173, and a Cyber 175 was signed December 22, 1978, with the China National Machinery Import and Export Corporation, the end user being the China National Oil and Gas Exploration and Development Corporation. Delivery of the systems was contracted for September 1, 1980.[72] A summary of the contract chapters and annexes is shown in Table 4.

TABLE 3.—*1978 CDC China business closed with CDF/CGG as a partner*

Order date and customer name.	*System type*
December 1978: Oil and Gas Corp., Tsuoshien	Add-on equipment.
December 1978:	
Oil and Gas Corp.:	
Urumchi	2 X Cyber 172's, Map II.
Tsamkong	2 X Cyber 172's, Map II.
Tientsin	2 X Cyber 172's, Map II.
Peking	2 X Cyber 172's, Map II.
December 1978: Oil and Gas Corp., Taching	Cyber 173, Map III.
December 1978: Oil and Gas Corp., Tsuoshien	Cyber 175, Map III.
December 1978: Geology Corp., Nanking	2 X Cyber 172's, Map II.

Source: Control Data Corp.

TABLE 4.—*CDC contract for complete equipment for a large-size seismic data processing center, 1978*

Chapter/annex and contents

Contract summary:
1. Subject of the contract.
2. Price.
3. Payment.
4. Delivery and terms of delivery.
5. Shipping documents.
6. Packing and marking.
7. Inspection.
8. Erection, calibration, and acceptance test.
9. Guarantees and claims.
10. Penalty for delayed delivery.
11. Dispatch of trainees and technical service.
12. Force majeure.
13. Taxes and duties.
14. Arbitration.
15. Effectiveness of the contract and miscellaneous.
16. Legal addresses.

Annexes:
1. Scope of supply and list of prices.
2. Contents, time, and manner of delivery for technical documentation and drawings supplied by seller.
3. Specimen of letter of guarantee issued by Banque Française du Commerce Extérieur, Paris.
4. Stipulation of calibration and acceptance of "equipments."
5. Terms of seller's acceptance of trainees sent by buyer.
6. Terms on service by seller's technical personnel.
7. Terms on F.C.O.'s.
8. Spare parts list.

Source: Control Data Corp.

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[72] Control Data Corporation, "Contract for Complete Equipment for Large Size Seismic Data Processing Centers," p. 5.

Although many contacts were made with the Chinese prior to the actual negotiations, it was only in April 1978 that serious discussion got under way, with the visit by CDF management to Peking.[73] A formal Chinese request for a proposal for three Cyber 173s for seismic processing was received on May 10, 1978. At this time negotiations by the Chinese were already under way with Hitachi and IBM.[74] The Chinese obviously were enamored with the prospect of exploiting their offshore oil reserves, which one U.S. oil geologist estimated as possibily totaling 30 billion barrels.[75]

The negotiations for these contracts, very similar to those for the first contract, began in earnest on June 1, 1978, in Peking and were conducted by CDF personnel. One of the principal questions of the Machimpex negotiators concerned the possibility of the United States granting an export license. In fact, the Chinese negotiator led off by stating, "We do not propose Control Data equipment because past experience has shown us that you have extreme difficulties in obtaining export licenses for it." [76] The CDC/CDF negotiator responded by acknowledging that "licenses for the exportation of these first machines were extremely difficult to obtain." He then countered saying that he would be "extremely surprised and disappointed" to discover that the Chinese penalize a company like CDC that "plays the role of a pioneer" in securing export licenses for such systems. The Chinese countered by asking if CDC was able to deliver this equipment rapidly to China. CDC responded affirmatively but did not ask for a precise explanation of what "rapidly" meant.

Following these sessions in Peking, CDC/CDF prepared a letter describing the Cyber equipment that could be negotiated and delivered rapidly. In an interoffice memorandum the CDC/CDF negotiators emphasized that the intent of the letter was to put the accent on the rapid delivery of the Cyber equipment while leaving the door open for the possibility of slightly more sophisticated equipment to be delivered on a medium- or long-term basis. The negotiators stressed, however, that considering the delivery requirements voiced by the Chinese, they refused to undertake negotiations for the sale of this more advanced equipment.

During the next few months the "getting to know you" scenario described in detail earlier was played almost with abandon by the Chinese. On June 20, for example, CDF management was invited by the PRC ambassador to France for an evening of discussions. In July a Chinese delegation that included 12 potential computer users visited CDF in Paris. Prior to the visit to CDF, this same Chinese delegation had visited the United States to "tour" CDC and Univac facilities,[77] and to "further understand the products and capabilities" of Univac and CDC. While in the United States some members of the Chinese delegation commented on CDC's competition. Some members of the delegation were very impressed by the Japanese marketing skill, particularly with the Japanese management staff's ability to speak fluent Chinese, their use of technically competent people to give presentations, and the provision of complete and detailed technical information. Other CDC competitors were also singled out, particularly IBM. Some delegation members, however, did not believe that IBM would be very successful in China because of the company's orientation toward commercial machines. In its documentation work IBM was averred "to be second to nobody." [78]

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[73] Control Data Corporation, "Presentation" (Minneapolis, August 30, 1979), p. 15.

[74] Ibid., p. 32.

[75] "The Scramble to Exploit China's Oil Reserves," Business Week, October 30, 1978, p. 155. According to A. A. Meyerhoff, a Tulsa, Oklahoma, geologist, these Chinese offshore oil reserves, if proved, could amount to all the proved reserves in the United States.

[76] Control Data Corporation, "Trip Report" (Minneapolis, August 9, 1978), p. 1.

[77] Control Data Corporation, "Interoffice Memorandum—The Visit of. . . . July 1, 1978–July 14, 1978" (Minneapolis, July 24, 1978), p. 1. It is interesting that in May this delegation had been in Japan visiting with Fujitsu, Hitachi, and NEC [A Japanese computer firm].

Continuing the "getting to know you" process, on September 15, 1978, the PRC ambassador to France again invited CDF management for a session with the Machimpex general manager, who was in Paris. In early November a Chinese Oil Ministry delegation visited CDF in Paris. This visit was followed, on November 23, by a Chinese invitation for CDF management to meet with the vice-minister of petroleum. A basic issue in these discussions was the equipment configuration. The Chinese, because of the immensity of the required exploration tasks, wanted the most powerful and sophisticated CDC computers and peripheral equipment available. CDC, aware of the export license problem, cautioned restraint. The issue was resolved and the $69.8 million contract was signed in Peking about eight months after the serious discussions began.

As of June 1981, however, the U.S. government still had not granted final approval for the entire transaction. CDC had been told "emphatically" at the very highest levels of U.S. government that the government wanted to provide special attention to China and that these systems should be approved and delivered promptly.[79] It was only a question of time. Ironically, in this instance it took CDC longer to negotiate with its own government concerning a commercial transaction than with the Chinese.

Other Ventures

CDC, like many other U.S. companies, is currently exploring a host of new commercial ventures with the Chinese. It is much too soon to predict the outcomes in terms of benefits obtained or the particular obstacles encountered in their negotiations. In any venture with U.S. firms, the Chinese have stated that "mutual benefit, mutual cooperation and long-term relationship" must apply to any pending association.[80]

Concerning commercial proposals related to computer technology, China will want to export products as part of a system, but will agree not to sell original equipment outside China. In a striking departure from past policies, China will agree to deferred payment terms, but interest payments and other terms will have to be in accordance with the International Convention of Paris.[81]

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[78] Ibid.

[79] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, April 10, 1980), p. 1.

[80] Control Data Corporation, "Interoffice Memorandum—People's Republic of China (PRC) Trip Report" (Minneapolis, August 20, 1979), p. 14.

[81] Ibid.

In a January 1980 letter to CDC concerning the establishment of a joint venture, the Chinese reiterated many of the problems attendant on such an enterprise.

> Through the many talks, both sides are quite clear that two key problems should be solved first: (1) How the Joint Corporation should compensate for the dollar expenditure on your side with dollars . . . and, (2) what about profits?[82]

The Chinese proposed that the problem of the dollar income be "solved" by the joint corporation's providing service in the United States through contracts to process and develop CDC software "for any other U.S. users." The dollar income of this business would be used "to compensate" for the necessary expenses in dollars. The Chinese suggested that it is "quite probable" that the joint venture "may lose in the first 2 years, balance in the third and make a little profit in the fourth and fifth years." In short, "if both sides trust and support each other, work hard together, it is possible to make a profit of ten percent after 5 years."[83]

The director of strategic studies and world-wide product planning for General Motors has put the problem of negotiating venture arrangements with the Chinese in a wider perspective than just profit and loss. General Motors is negotiating an equity joint venture with the First Ministry of Machine Building covering the manufacture and sale of heavy-duty trucks to China. In addition to General Motors, three European companies and two other U.S. companies are negotiating with the First Ministry. This General Motors executive observed that discussion with Chinese officials regarding equity joint venture possibilities revealed a noticeable lack of communication between various ministries and government agencies as well as the presence of a high degree of competition and rivalry. This situation not only is at the center of bureaucracy; a similar condition exists between central and local authorities. This lack of cooperation and the overlapping of responsibilities complicate the joint venture negotiation process, since answers to critical questions may be different, depending on the source.[84]

CDC's approach to the China market is best summarized in one of the company's review memorandums written in April 1980:

> To assist China in its modernization and development plans, thereby securing long term markets and supply sources for CDC; large enough to get the attention of the power and policy centers in China and basic enough to be essential to their future; and a synergistic and total approach to a specific product and geographical areas that link selling and buying in a cohesive package.[85]

In order to be successful in China, CDC suggests that a sustained, long-term effort of 5 to 10 years may be required. In short, the substantial profits will go to the long distance runners—or, as the Chinese might say, "to the old friends."

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[82] Chinese Foreign Trade Corporation, "Letter to Control Data Corporation" (Peking, January 10, 1980), p. 1.

[83] Ibid.

[84] National Council for U.S.-China Trade, "Selling Technology to China: Proceedings of the Conference on Selling Technology to China." Washington, D.C.: National Council for U.S.-China Trade, December 1979, p. 126.

[85] Control Data Corporation, "Interoffice Memorandum" (Minneapolis, April 10, 1980), p. 2.

THE UNITED STATES-CHINA JOINT ECONOMIC COMMITTEE

By Patricia A. Haas*

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INTRODUCTION

With the establishment of diplomatic relations between the the United States and the People's Republic of China in January 1979, a 30-year era of political estrangement ended and the process of economic normalization began. The importance both governments attached to this effort was underscored when President Carter and Vice Premier Deng Xiaoping agreed to establish the U.S.-China Joint Economic Committee (JEC) as the institutional mechanism to oversee the development of bilateral economic relations. The subsequent three years witnessed the emergence of a bilateral economic relationship whose rapid development has been almost as remarkable as the reversal of the U.S.-China political relationship from enmity to friendship.

The re-establishment of bilateral trade, financial and investment ties with the People's Republic of China has been the result of carefully orchestrated efforts by both governments. These efforts sought to remove impediments to normal economic interchange which had been erected for political reasons, and to provide common ground rules for meshing two very different economies—both enormous in terms of size and resources but far apart in terms of market-orientation and stage of development. Each government moved quickly through a series of high level exchanges and negotiations to tackle the process of economic normalization; within the American Government, the U.S.-China Joint Economic Committee was established to coordinate the implementation of this objective.

NORMALIZATION OF ECONOMIC RELATIONS

While January 1, 1979 signaled the culmination of bipartisan efforts, beginning with President Nixon and spanning almost a decade, to normalize political relations, it also marked the beginning of a new period of economic relations. Over the preceding thirty years, economic relations had been virtually nonexistent. Bilateral trade in 1977 was $374 million—a small fraction of the $5.5 billion it reached at the end of 1981. Commercial relations were hampered by the absence of both a bilateral trade agreement and most-favored nation tariff treatment (MFN).[1] In addition, Chinese commercial property in the U.S., such as vessels entering U.S. ports, was subject to attachment by American claimants whose assets (valued at $196 million) had been taken by the Chinese Government after the 1949 revolution.[2]

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*The opinions expressed in this article are those of the author and do not necessarily reflect those of the Treasury Department.

Private banking and financial transactions were inhibited by the Johnson Debt Default Act of 1934 which prohibits U.S. individuals and corporations from making loans to, or purchasing the securities of, any foreign government which is in "default" on its obligations to the U.S. Government.[3] U.S. Government export credits provided by the Export-Import Bank (Eximbank), foreign assistance provided by the U.S. Agency for International Development (AID), and investment insurance offered by the Overseas Private Investment Corporation (OPIC) were also restricted by U.S. law.[4] Transportation and communication links were lacking as well.

THE UNITED STATES-CHINA JOINT ECONOMIC COMMITTEE UNDER THE CARTER ADMINISTRATION

With political normalization achieved, President Carter and his cabinet recognized the importance of removing existing obstacles and establishing a framework for normal economic interchange.

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[1] In addition to granting non-discriminatory tariff treatment, a trade agreement addresses trade promotion, business facilitation, financial transactions, industrial rights protection and consultation procedures concerning market disruption. Section 402, the Jackson-Vanik amendment, of the Trade Act of 1974 prohibits the extension of U.S. Government credits or guarantees to non-market economy countries which deny their citizens the right or opportunity to emigrate. The prohibitions of Section 402 can be waived, by Executive Order, if the President can report to Congress that he has received assurances from the country in question that the waiver will substantially promote the objectives of the section. The application of the Jackson-Vanik amendment to China was waived on February 1, 1980.

[2] When diplomatic relations with the People's Republic of China were established, the United States had validated claims against the PRC for $196 million worth of property of U.S. nationals taken by the PRC in 1949–1950. The PRC had claims against the U.S. totaling $80 million for assets blocked by the U.S. under the Foreign Assets Control Regulations. Resolution of the claims/assets problem was an immediate concern to both governments after normalization, in part, to avert potential attachment of Chinese property by U.S. claimants. For a thorough discussion of this issue see Natalie Lichtenstein's article in this compendium "Unfrozen Assets: The 1979 Claims Settlement between the United States and China."

[3] In 1979, there were approximately $350 million worth of outstanding obligations of the Government of China incurred prior to 1949, including Eximbank loans, and lend-lease and surplus property accounts, and $250,000 worth of postal debts incurred by the PRC between 1949 and 1972. Applicability of the Johnson Debt Default Act to China, however, was clouded by the fact that the PRC was never determined to be the party in default on these debts. In October 1979, the United States decided that it would temporarily set aside the issue of the old Eximbank loans ($26.4 million plus accrued interest of $9.3 million) in order to help U.S. firms take advantage of new opportunities to export to China, and in January 1980, the PRC completed repayment of its outstanding postal debt to the U.S. Further question of applicability of the Act to China was removed when the PRC assumed membership in the International Monetary Fund and the World Bank in the spring of 1980, since the Act does not apply to members of those institutions.

[4] Apart from Section 402 of the Trade Act of 1974 which restricted the granting of MFN through a bilateral trade agreement, and the extension of Eximbank credits and OPIC guarantees to the PRC, there were additional legal impediments regarding the extension of official assistance and guarantees to China. The Foreign Assistance Act of 1961, as amended, prohibited the extension of foreign assistance to China under Sections 620(b) and 620(f), and similarly restricted OPIC programs unless there was a specific exemption for China under Section 239(g). Section 2(b)(2) of the Export-Import Bank Act of 1945, as amended, flatly prohibited Eximbank from extending credit or insurance or issuing guarantees to China unless the President determines that it is in the national interest.

They were equally concerned that U.S. economic policy toward China be consistent with overall U.S. foreign policy objectives. To ensure that economic policy toward China was carefully coordinated and reflective of U.S. strategic interests, the Carter Administration considered the merits of establishing a joint economic committee with the Chinese. It was envisioned that this committee would differ from joint commissions the United States had with other non-market economy countries which by late 1978 were focusing primarily on trade promotion and business facilitation.[5] While commercial issues were recognized as a critical ingredient in an economic relationship with China, one of the major objectives of U.S. policymakers in the early days of normalization was to set up a forum which would oversee the reestablishment of all aspects of economic ties, such as finance, investment, trade, business facilitation, transportation, agriculture, etc. During their January 30, 1979 meeting in Washington, President Carter and Vice Premier Deng Xiaoping discussed the possibility of creating a bilateral forum and agreed to establish a joint economic committee.

Treasury Secretary W. Michael Blumenthal was appointed by President Carter to negotiate the specific arrangements for the establishment and functioning of the committee. In February 1979 he visited China to meet with Vice Premier Yu Qiuli, a leading Chinese official with broad economic policy responsibilities and head of the State Planning Commission. During this visit, an agreement was reached regarding the specific purpose and nature of the joint committee, which was formally named the U.S.-China Joint Economic Committee (JEC).[6] As had been agreed by President Carter and Vice Premier Deng Xiaoping, it was decided that this committee would serve as the focal point for both governments to meet at least annually to coordinate and oversee the development of their economic relations. Secretary Blumenthal and Vice Premier Yu were appointed co-chairmen; their delegations were to consist of representatives of ministries and agencies with economic responsibilities in their respective governments. An initial JEC agenda was also agreed on; it included settlement of official and private claims; trade, aviation, and shipping agreements; business facilitation; taxation and expansion of banking ties. In addition, Secretary Blumenthal and Finance Minister Zhang Jingfu initialed an agreement resolving the claims/assets problem. Both sides also opened discussions on trade, banking and tax issues.[7]

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[5] These are the: Joint U.S.-U.S.S.R. Commercial Commission; Joint American-Polish Trade Commission; Joint American-Romanian Economic Commission; and the U.S.-Hungarian Joint Economic and Commercial Committee.

[6] Please see Appendix I for the text of this Understanding.

[7] Once the question of private claims and frozen assets was largely settled, it was agreed to begin discussions of a bilateral trade agreement. State Assistant Secretary Katz and Wang Runsheng, Vice Minister, Ministry of Foreign Trade held preliminary talks on elements of a trade agreement. Tax discussions were led by Treasury Deputy Assistant Secretary Sunley and Lin Rongsheng, Deputy Director of the General Tax Department, Ministry of Finance. The U.S. side outlined U.S. income tax as applied to corporations, U.S. tax treatment of foreign-source income, and administration of U.S. tax laws. The Chinese described their industrial/commercial consolidated tax and income tax. Two other current taxes were also mentioned: the vehicle tax and city real estate tax. Much of the discussion, however focused on the U.S. foreign tax credit. Banking talks, led by Treasury Under Secretary for Monetary Affairs Anthony Solomon and Chairman of the Bank of China Qiao Peixin, included a review of international financial institutions, U.S. Eximbank operations, the Chinese banking system and foreign bank operations in China and the United States. The Chinese indicated an interest in establishing a branch office of the Bank of China in New York.

Over the next eighteen months, each government began to address items on the JEC agenda. On the U.S. side, the Carter Administration consulted with the Congress about the application of the Jackson-Vanik Amendment to China and the steps required to qualify China for MFN tariff treatment and U.S. Government export credits. Through diplomatic channels, negotiations were initiated on trade, textile, aviation and shipping agreements. Subsequently, both sides agreed to delay the first formal JEC meeting until some time in 1980, when it was expected that many of the initial JEC agenda items would be resolved.

There had been considerable progress by the time the first session of the Joint Economic Committee met on September 16-18, 1980 in Washington. The Claims Settlement and Trade agreements had been formally signed. Two-way trade during 1979 had reached $2.3 billion—almost double that of 1978—and was expected to approach $4 billion by the end of 1980. By mid-year 1980, more than 50 American banks had correspondent relations with the Bank of China, and the U.S. Congress, at the urging of the Executive Branch, had taken the necessary legal steps to permit China's access to Eximbank, OPIC and the Trade and Development Program (TDP).[8]

Similarly, the overall U.S.-China relationship had broadened substantially by mid-September 1980. The most obvious manifestation was the burgeoning private and official contact between the two countries. On the heels of numerous cabinet visits to both countries came Chinese delegations to the U.S.—averaging 100 per month, and American tourists to China—more than 60,000 in the first half of 1980. Consulates general had been opened by the U.S. Government in Guangzhou (Canton) and Shanghai, and by the Chinese in San Francisco and Houston. A bilateral science and technology commission had been established to oversee cooperation and implementation of protocols in more than 16 areas. A cultural exchange agreement and implementing accords had also been signed. Although there was no formal understanding for a security relationship, U.S. export controls were being modified to permit sales of certain military support equipment to China.

Thus, the first session of the U.S.-China Joint Economic Committee had a solid political framework as a backdrop and itself was a highly visible and successful event in the development of bilateral economic ties. It underscored the U.S.-China economic relationship as one of the most important results of the establishment of diplomatic ties. The September 1980 JEC session, chaired by Treasury Secretary G. William Miller and Chinese Vice Premier Bo Yibo, culminated in a White House ceremony during which President Carter and Vice Premier Bo signed bilateral textile, civil aviation, maritime and consular agreements.[9] On that occasion, President Carter stated that "the normalization of relations between the United States of America and the People's Republic of China is at last complete."

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[8] An agreement on staging trade exhibitions was signed during Commerce Secretary Kreps' trip to China in May 1979. Subsequent exchanges of economic officials included U.S. Federal Reserve Board Chairman Paul Volker, Chinese Finance Minister Zhang Jingfu, Foreign Trade Minister Li Qiang, People's Bank of China Chairman Li Baohua and Bank of China Chairman Bu Ming. Vice President Mondale visited China in August 1979, and announced that the U.S. Eximbank was prepared to make $2 billion in credits available to China on a case-by-case basis. China was also determined to be a "friendly country" so it could be eligible for "reimbursable" development assistance in compliance with Section 607 and 661 of the Foreign Assistance Act of 1961, as amended. The Agreement on Trade Relations between the U.S. and PRC, which was signed on July 7, 1979, was submitted by the Administration to the Congress on October 23, 1979 with the necessary Presidential waiver package (implementing proclamation and emigration assurances). It was approved by both Houses of Congress and entered into force on February 1, 1980. Once the Jackson-Vanik prohibitions were waived, Eximbank needed only a Presidential national interest determination to begin lending to China. This was made on April 2, 1980. The Senate and House of Representatives on July 21 and July 28, 1980, respectively, approved legislation to permit OPIC programs in China. The President signed this legislation on August 8, 1980 and made the necessary national interest determination. In addition, by September 1980, both governments had finished negotiation of textile, consular, civil aviation and maritime agreements.

Although substantial progress had been made, the Committee still had a number of important matters to discuss. To allay concerns about China's economic retrenchment, Vice Premier Bo emphasized that China's policies to modernize and expand foreign economic relations would be continued. Throughout his U.S. visit, Vice Premier Bo encouraged the American private sector to be patient as China readjusted its economy and to look to the longer-term opportunities for trade and investment which China's modernization program might offer.[10] In terms of bilateral relations three general issues emerged as the center of the JEC discussions.[11] At the forefront was the question of finance. China's access to U.S. Government programs such as Eximbank, the Commodity Credit Corporation, the Trade and Development Program, and the Overseas Private Investment Corporation was reviewed.[12] It was noted, however, that the terms and amounts of credits available under U.S. Government programs were less favorable than some of those offered by the Europeans and Japanese. In response to inquiries about U.S. assistance on more favorable terms, the U.S. side explained that the terms offered by Eximbank were the best it could provide worldwide and that legislative constraints prohibited U.S. foreign aid to China.[13]

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[9] The Textile Agreement provides a framework for the orderly development of bilateral textile trade. It applies to textile products exported from China between January 1, 1980 and December 31, 1982 and establishes agreed levels of trade for six textile products. It also includes a consultation mechanism for textile categories not subject to specific ceilings. This agreement, signed after eighteen months of negotiations, was particularly significant since, at the time of its conclusion, China was the fifth largest supplier of textile products to the U.S. The Civil Air Transport Agreement provided for the establishment of regularly scheduled, direct flights between the U.S. and China. It called for the initial designation of one airline by each side and addressed routes, capacity and carriage of traffic, pricing and charters. The Maritime Transport Agreement opened American and Chinese ports to merchant ships of both countries for the first time in thirty years. Its most important provisions deal with port access and cargo-sharing. The latter provision entitles the U.S. and Chinese fleet to carry at least one-third of the bilateral general and bulk cargo shipments. The Consular Convention stipulates duties of American and Chinese consular officers and expands protection and services for citizens of both countries. It also provides for the establishment of three additional consulates general in each country.

[10] The Chinese have repeatedly sought to dissuade American private sector fears about diminishing business opportunities in China due to Beijing's investment cutbacks in capital construction projects. In a March 1981 meeting with U.S. industry leaders, Vice Premier Bo stated that "during retrenchment, Sino-U.S. trade may develop at a slower pace than previously, but afterwards the results will be quite spectacular."

[11] Please see Appendix II for a delegation list.

[12] At the time of the JEC, Eximbank had issued one preliminary commitment to assist U.S. exports of $80 million worth of steel making equipment to China—although this credit had not been finalized since the Chinese postponed completion of the Baoshan steel project where the equipment was to be used. China was made eligible for full use of the Commodity Credit Corporation (CCC) by passage of the Agricultural Trade Act of 1978 and the U.S.-China Trade agreement. The Chinese have still not requested use of this program, which provides direct credits and guarantees to finance sales of U.S. agricultural goods abroad. Their reluctance is probably due to the high interest rates for direct credits which are offered slightly above market rates. The Trade and Development Program had funded two technical exchanges under the U.S.-PRC Hydropower Protocol by September 1980. The Overseas Private Investment Corporation still needed to conclude a bilateral investment guaranty agreement before it could commence programs in China, although it had received an expression of interest in coverage from more than eighty American companies.

The second major issue of discussion was bilateral trade, including China's trade deficit with the U.S. The JEC recognized that two-way trade in 1979 was weighted in favor of the United States and that some Chinese exports were potentially sensitive to U.S. domestic industry. U.S. exports for 1979 totaled approximately $1.7 billion while Chinese exports accounted for roughly $595 million—the bulk of which was textiles and other light industry goods.

The final issue pertained to the role American firms could play in China's modernization program. The JEC acknowledged the interests of American firms with their advanced technology in developing business ties with China. The U.S. delegation stressed the importance of pursuing measures to facilitate business, noting that lack of adequate commercial and banking operating conditions and physical facilities in China could hinder the expansion of business contacts. In addition, the U.S. delegation mentioned that it would be useful to have more information about China's capital construction projects and China's investment priorities.

In concluding, both governments recognized that despite previous accomplishments an agenda of items remained to be addressed. These were in the following areas: (a) business facilitation—availability of multiple entry visas, freer travel and adequate working conditions for businessmen in China; (b) trade expansion—promotion of exports and reduction of import barriers; (c) government finance and investment programs—clarification of questions regarding Eximbank and OPIC programs; (d) banking—expansion of banking operations in each country; (e) taxation—exchange of information on the two countries tax systems and eventual negotiation of a bilateral income treaty; and (f) investment—exploration of commercial opportunities and procedures for investing in each country.

Discussion of many of these issues continued after the first Joint Economic Committee meeting. Informal meetings of the Commerce Department-chaired JEC working group on Business Facilitation and Major Projects were held in November 1980 during the opening of the U.S. trade exhibition in Beijing. These talks centered on improving operating conditions for U.S. companies operating in China. Progress was made on the questions of adequate office and housing space, multiple-entry visas, removal of travel restrictions for businessmen and the establishment of government trade offices in both countries.

The dialogue on trade practices and policies continued during United States Trade Representative Askew's trip to China in the fall of 1980 and in meetings in January 1981. Both governments examined ways to maximize bilateral trade potential and to ensure orderly marketing of sensitive products in each country. Regarding taxation, Treasury Department tax officials met with their counterparts in October and November 1980 and in May and September 1981 to discuss issues such as China's joint venture and individual income tax laws, U.S. foreign tax credit, U.S. model income tax treaty and taxation of civil aviation and maritime profits.[14] Bilateral grain and OPIC agreements were signed in October 1980, and Eximbank agreements were concluded in May 1981.[15] Eximbank approved in September 1981 requests for the financing of $75 million of turbine generators and boiler components exports.

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[13] Please refer to footnote 4.

Cooperation in science and technology also expanded, especially in the hydropower area following the signing of a Protocol on U.S.-China Hydropower Cooperation. The Trade and Development Program (TDP) of the International Development Cooperation Agency assisted in financing technical exchanges under this protocol, which aimed to increase U.S. private sector involvement in the development of China's hydropower potential. Bilateral trade and banking ties also continued to expand, resulting in U.S.-China trade surpassing $4.8 billion by the end of 1980. At that time the Bank of China had correspondent relations with approximately sixty U.S. banks and had applied to the Comptroller of the Currency for a license to establish a Federal branch office in New York City.[16]

THE UNITED STATES-CHINA JOINT ECONOMIC COMMITTEE UNDER THE REAGAN ADMINISTRATION

When the Reagan Administration assumed office in January 1981, it inherited a healthy political and economic relationship with China. Secretary of State Haig's visit to China in June 1981 symbolized the importance the new Administration attached to further improving relations. During his trip, Secretary Haig emphasized the importance of continuing high level government talks on economic relations.[17] In this regard, he discussed the JEC with

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[14] The fall 1980 discussions were led by Treasury Assistant Secretary for Tax Policy Donald Lubick and Mr. Lin Rongsheng, Deputy Director of the General Bureau of Taxation of the Ministry of Finance. These talks centered around China's joint venture and individual income tax laws, which were promulgated in September 1980, and creditability of taxes paid by U.S. individuals and corporations in China against U.S. income taxes. Much of the discussion addressed U.S. private sector concerns about the extent to which taxation of income derived from petroleum in China would be creditable against U.S. income tax. Although the joint venture income tax provides tax rates for most joint ventures, it states that the tax rate on petroleum, natural gas and other natural resources will be stipulated separately. The U.S. side explained the U.S. foreign tax credit and typical provisions of a U.S. tax treaty although the Chinese did not indicate an interest in beginning negotiations. Reciprocal exemption of taxation on maritime and aviation profits was also discussed. Reagan Administration tax officials continued discussions on these issues in May and September 1981.

[15] A United States-China Grain Agreement was signed October 21, 1980. The four-year agreement, which went into effect January 1, 1980 and commits China to purchase 6-9 million metric tons of wheat and corn annually, highlights the importance of bilateral agricultural trade. In 1980 United States agricultural exports to China accounted for approximately forty percent of total United States exports to China which were nearly $3.8 billion. A bilateral OPIC Agreement was signed October 30, 1980 which included the necessary provisions for arbitration, subrogation and foreign government approval of projects, the final prerequisite step before OPIC could authorize programs in China. The Eximbank agreements, overall operating and loan agreements, provide the procedural guidelines for Eximbank lending to China. Their conclusion, however, was not mandatory in order for Eximbank to consider loans for United States exports to China.

[16] On March 25, 1981 the Bank of China applied to the Comptroller of the Currency for a license to establish a Federal branch pursuant to the International Banking Act of 1978. The application was approved on June 2, 1981 and a New York branch office was licensed on September 18, 1981. The New York branch opened for business on November 16, 1981. This office provides full banking services including taking deposits and making loans.

[17] In addition, Secretary Haig discussed broad strategic issues and also announced American willingness to consider selling arms to China. He also informed the Chinese of the President's decision to review legislation, no longer consistent with current relations, which prohibits commercial cooperation with China, and to seek appropriate Congressional action to end such dis-

Continued

Vice Premier Bo who offered to co-chair the next meeting in Beijing in the fall of 1981 with Treasury Secretary Donald T. Regan, the new American chairman. Secretary Haig also proposed that a new joint commission be established to address trade and commercial matters which had arisen with the rapid expansion of trade. This commission, to be chaired on the American side by the Commerce Department Secretary, would promote trade and facilitate the expansion of business contacts.

In order to broaden economic cooperation, both Americans and Chinese have pointed to a full agenda of economic issues for the Reagan Administration to address. The U.S. private sector has continued to lobby specifically for multiple-entry visas, more efficient visa procedures, fewer travel restrictions and more adequate office space in China. They have urged both governments to pursue bilateral tax, patent and investment agreements, and to oversee the orderly marketing of Chinese exports in the U.S. Other Americans have argued that their Government should modify legislation which prohibits aid and technical assistance programs for China, and should also liberalize tariff treatment when China becomes eligible for the US Generalized System of Preferences (GSP).[18] In discussions with their American counterparts, the Chinese have inquired about: increased investment in light industry to boost exports and foreign exchange earnings; increased technical advice and cooperation to modernize existing plants and China's infrastructure; and increased cooperation in oil, coal and hydropower sectors. The Chinese have also urged the removal of trade restrictions. In particular, they have indicated that U.S. export control policy has caused the delay of American technology sales to China, and that U.S. import policy has constrained the ability of China to export to the United States, especially Chinese textile products.

Many of these issues were discussed when Treasury Secretary Regan visited China in mid-November 1981 for the second session of the United States-China Joint Economic Committee. Like the first session, numerous agencies in each government participated in the three day meeting.[19] There were two plenary sessions which allowed for a broad review of bilateral economic relations and economic developments in each country, and working group meetings on finance and investment, taxation, trade and the exchange of economic information.[20] Secretary Regan also met with Premier Zhao Ziyang and Vice Chairman Deng Xiaoping.

Throughout the meetings both governments reviewed with satisfaction the rapid development of the United States-China economic

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crimination. As a result, four statutes have been examined: The Foreign Assistance Act of 1961, as amended; The Agricultural Trade Development and Assistance Act of 1954 (PL-480); Tariff Schedules of the U.S. (Importation of Furskins); and The Export-Import Bank Act of 1945, as amended.

[18] In order for China to receive GSP, it would have to be designated a beneficiary developing country under Section 502 of the Trade Act of 1974. However, the President may not designate any Communist country a beneficiary developing country unless (1) its products receive MFN, (2) it belongs to both the General Agreement on Tariffs and Trade (GATT) and IMF, and (3) it is not dominated or controlled by international communism. Although China has been accorded MFN treatment and is a member of the IMF it does not belong to the GATT. GSP treatment, would enable many Chinese exports to the United States to benefit from zero tariffs.

[19] Please see Appendix III for a delegation list.

[20] Please see Appendix IV for a joint Press Release which was distributed at the conclusion of the meetings on November 18, 1981.

relationship and restated their commitment to ensure its continued expansion. Both governments agreed to meet periodically over the year to follow up on issues raised at the second JEC meeting and to prepare for the third session, which will be held in Washington in the fall of 1982.

APPENDIX I

UNITED STATES-CHINA JOINT ECONOMIC COMMITTEE UNDERSTANDING

Below is a description of the purpose and nature of the United States-China Joint Economic Committee as agreed to by Treasury Secretary Blumenthal and Vice Premier Yu Qiuli representing their respective governments, in Beijing, March 1, 1979.

JOINT ECONOMIC COMMITTEE

President Carter and Vice-Premier Deng agreed to the establishment of a joint enconomic committee during their discussions in Washington. As viewed by the President, the Committee's purpose will be to serve as the focal point for interaction between our two governments on economic issues. The Committee will be charged with coordinating and overseeing the orderly development of economic relations between the United States and the People's Republic of China. The agenda for the Committee will include trade, technological, investment and financial matters.

The United States proposes that this body formally be named the U.S.-China Joint Economic Committee and that it function as follows:

The Committee shall have an American and a Chinese co-chairman. Each government will appoint a senior economic official as co-chairman. President Carter has appointed Secretary Blumanthal to chair for the United States. The Chinese Government has appointed Vice Premier Yu Qiuli;

The co-chairmen would be responsible for setting the agenda for the Joint Economic Committee. In effect they would chart or "direct" the development of the U.S.-Sino economic realtionship in consultation with their superiors and with the other members of the Committee;

In addition to the two Co-chairmen, the membership of the Joint Economic Committee would include the senior officials from each government whose responsibilities will affect or by affected by decisions made by each government on the economic interaction between the United States and China. For the United States the following Presidential officers and advisors will be appointed to the Committee: The Secretary of Commerce, Secretary of Labor, Secretary of Agriculture, Secretary of Transportation, Secretary of Energy, the Special Trade Representative, the President's Science Advisor, the Director of the Export-Import Bank and the Deputy Secretary of State;

The interaction between the above-named officials and the Chinese Government on economic matters will be facilitated and coordinated by the Co-chairmen of the Committee and similarly for the Chinese appointees' interaction with the United States Government;

The Co-chairmen of the Joint Economic Committee should meet frequently, at least once a year; or depending on specific items on the agenda, they may designate representatives to preside over joint sessions of the committee. It is proposed that Vice Premier Yu Qiuli and Secretary Blumenthal meet in Washington at a mutually convenient time to review the work set out in the described agenda below;

If the Vice Premier elects to come to Washington, he should be accompanied by representatives of the other officials on the Chinese side of the Committee. Similarly, when the Secretary of the Treasury visits Peking on Committee business, he will be accompanied by representatives of the U.S. side of the Committee, as is the case during the present visit of Secretary Blumenthal to Peking;

In addition it is envisioned that the Co-chairmen will communicate with each other through cables, written correspondence and envoys on specific economic matters that arise, in order to ensure that they are coordinated by the Committee;

Each Co-chairman will appoint a representative in his government's embassy to serve as his liaison with his counterpart;

The initial agenda for the Joint Economic Committee will include;

(1) settlement of private claims;

(2) settlement of the issue of the claims of both governments;

(3) resolution on the various requirements of a trade agreement, including the granting to China by the United States of Most Favored Nation trading status and provision for official credits;

(4) business facilitation;

(5) an aviation agreement;

(6) a shipping agreement;

(7) satisfactory resolution of the issue of China's taxation of income of U.S. corporations operating in China and the U.S. taxation of income of Chinese enterprises operating in the U.S.;

(8) the establishment of Bank of China offices in the United States;

(9) any other issue that either side wishes to raise.

APPENDIX II

UNITED STATES-CHINA JOINT ECONOMIC COMMITTEE, SEPTEMBER 16-18, 1980

WASHINGTON, D.C.

DELEGATION LIST

United States Delegation

Treasury Department

Secretary Miller; Assistant Secretary Bergsten; Deputy Assistant Secretary Cornell; Herbert E. Horowitz, Director, Office of East West Economic Policy; William Barreda, Director, Office of International Trade; Russell Munk, Assistant General Counsel; Patricia Haas, International Economist; Natalie Lichtenstein, Attorney; and Bruce Palmer, Attorney.

Commerce Department

Under Secretary Hertzstein; Deputy Assistant Secretary Nath; David Laux, Director, China Division; Roger Severance, Acting Director, Office of East-West Country Affairs; Arnold Weiss, Acting Director, Office of East-West Trade Development; Roger Stechschulte, Director, Trade Development Assistance Division; Christine Lucyk, China Division; David Denny, China Division; Jackson Rich, China Division; Liliana Monk, China Division; Elaine DiFederico, China Division; and Michael Kirk, Patent Office.

U.S.T.R.

Robert Hormats, Deputy U.S. Trade Representative; John Ray, Assistant U.S. Trade Representative; Mark Orr, International Economist; and Judith Hancock, Attorney Advisor.

Department of State

Under Secretary Cooper.

Bureau of East Asian Affairs

Deputy Assistant Secretary Michael Armacost; Scott Hallford, Deputy Director, Office of Chinese Affairs; Jerome Ogden, Economic Section Chief, Office of Chinese Affairs; and William Piez, Director, Office of Economic Policy.

Bureau of Economic and Business Affairs

Assistant Secretary Deane Hinton; Richard Mueller, Deputy Director, Office of East-West Trade, and Steven Gallogly, Economic Officer, Office of East-West Trade.

Office of Legal Advisor

John Crook, Assistant Legal Advisor.

U.S. Embassy Beijing

Ambassador Woodcock; and Walter Lenahan, Economic Counselor.

Eximbank

John Moore, President and Chairman; Warren Glick, General Counsel; and Ray Albright, Vice President.

Overseas Private Investment Corporation

J. Bruce Llewellyn, President, Paul Gilbert, Vice President and General Counsel; and Anthony Marra, Attorney.

Trade and Development Program

David Raymond, Director.

Department of Energy

Les Goldman, Assistant Secretary; and Holsey Handyside, Deputy Assistant Secretary.

Department of Agriculture

James Starkey, Deputy Under Secretary.

Department of Labor

Dean Clowes, Deputy Under Secretary.

National Security Council

Roger Sullivan.

Office of Science and Technology Policy

Ben Huberman, Associate Director.

Chinese Delegation

Bo Yibo, Delegation Leader, Vice Premier, State Council of the People's Republic of China; Wang Bingqian, Deputy leader of the delegation, Minister, Ministry of Finance; Chai Zemin, Ambassador of the People's Republic of China to the United States; Gan Ziyu, Secretary-General of the delegation, Vice Chairman, State Planning Commission; Xie Beiyi, Vice Chairman, State Capital Construction Commission, Vice Chairman, Foreign Investment Control Commission; Xu Chi, Vice Chairman, State Machine Building Industry Commission, Vice Minister, Ministry of Metallurgical Industry; Wang Runsheng, Vice Minister, Ministry of Foreign Trade; Wang Weicai, Vice Chairman and Vice President, Bank of China; Zou Siyi, Director, Export Bureau, Ministry of Foreign Trade; Ji Chaozhu, Deputy Director, Department of American and Oceanian Affairs, Ministry of Foreign Affairs; Wang Liansheng, Deputy Director, Department of External Finance, Ministry of Finance; Pei Chao, Deputy Director, Import Bureau, State Import-Export Commission; Cai Liheng, Deputy Director, State Science and Technology Commission.

Staff Members (traveling with Vice Premier Bo)

Wang Li, Division Chief, Department of American and Oceanian Affairs, Ministry of Foreign Affairs; Li Miao, Staff Member, Ministry of Finance; Chen Shibiao, Interpreter, Third Bureau, Ministry of Foreign Trade; and Zha Peixin, Interpreter, Ministry of Foreign Affairs.

Chinese Embassy Delegation Members and staff

Peng Jinbo, Counselor (Commercial Affairs); Li Wei, First Secretary; Huang Jianmo, Second Secretary; and Zhang Xueyao, Second Secretary.

Working group chairmen

Working Group I, Business Facilitation and Major Projects, Robert Herzstein and Wang Runsheng; Working Group II, Trade Policy, John Ray and Gan Ziyu; Working Group III, Finance and Investment, C. Fred Bergsten and Xie Beiyi.

APPENDIX III

U.S.-CHINA JOINT ECONOMIC COMMITTEE, NOVEMBER 16-18, 1981

BEIJING

DELEGATION LIST

Treasury Secretary Donald T. Regan.

Arthur W. Hummel, U.S. Ambassador to the People's Republic of China; Martin Anderson, Assistant to the President for Policy Development; Beryl W. Sprinkel, Treasury Under Secretary (Monetary Affairs). Marc E. Leland, Assistant Secretary for International Affairs; William H. Draper III, President and Chairman, Eximbank; Edward V. Hickey, Deputy Assistant to the President; John E. Chapoton, Treasury Assistant Secretary (Tax Policy); W. Dennis Thomas, Treasury Assistant Secretary (Legislative Affairs); Ann D. McLaughlin, Treasury Assistant Secretary (Public Affairs); Charles W. Freeman Jr., Minister-Counselor, U.S. Embassy; Norman A. Bailey, National Security Council, Director Planning and Evaluation Division; Raymond J. Albright, Eximbank Vice President; Christian R. Holmes, Trade and Development Program Director; Sidney L. Williams, Overseas Private Investment Corporation, Vice President and General Counsel.

Anthony C. Albrecht, State, Deputy Assistant Secretary (EA); Robert A. Corneli, Treasury, Deputy Assistant Secretary (Trade and Investment); Eugene K. Lawson, Commerce, Deputy Assistant Secretary (East-West Trade); Alan W. Granwell, Treasury, International Tax Counsel; E. George Cross III, Treasury, Special Assistant to Secretary Regan; Patricia A. Haas, Treasury, International Economist; Bruce B. Palmer, Treasury, Attorney Advisor, Office of the Assistant General Counsel for International Affairs; Richard W. Mueller, State, Deputy Director Office of Chinese Affairs; Philip T. Lincoln Jr., State, Deputy Director, Office of Investment Affairs; David N. Laux, Acting Commercial Counselor, U.S. Embassy; Mark Z. Orr, USTR, Director, East-West Trade Policy; Jerome Kuhl, Counselor for Agricultural Affairs, U.S. Embassy.

Arthur S. Macias, Counselor for Consular Affairs, U.S. Embassy; David G. Brown, Counselor for Economic Affairs, U.S. Embassy; Henry A. Englebrecht, Economic Counselor, Consulate General, Hong Kong; Louis G. Sleeper, Regional Attache for Asia, Consulate General, Hong Kong; Alfred M. Crocker, First Secretary (Press Officer), U.S. Embassy; Marcia D. Field, Treasury, Associate Director, International Tax Affairs; Steven R. Lainoff, Treasury, Attorney, International Tax Counsel; Robert M. Field III, NFAC, Economist; Richard Boucher, State, Economic Officer, Economic Bureau/East-West Trade; Nancy L. Fiester, Treasury, Confidential Secretary to Secretary Regan; Patricia M. Cox, Treasury, Delegation Secretary; Sanford Shapiro, Treasury, Administrative Control Officer.

II. Advisors

Anthony S. Babin, First Secretary (Admin. Coordinator), U.S. Embassy; John P. Modderno, First Secretary, U.S. Embassy; Howard H. Lange, First Secretary, U.S. Embassy; Kent M. Weidemann, First Secretary, U.S. Embassy; Frederick W. Maerkle, First Secretary, U.S. Embassy; Robert A. Phillips, Second Secretary, U.S. Embassy; Peter Hanley, Foreign Commercial Service TDY Officer, U.S. Embassy; Jeffrey Lee, Commerce TDY Officer, U.S. Embassy; Vivian Chang, State, Interpreter for Secretary Regan; James W. Brown, State, Interpreter.

CHINESE DELEGATION LIST

Bo Yibo, Vice Premier.

Wang Bingqian, Minister of Finance, Finance Ministry; Gan Ziyu, Vice Minister, State Planning Commission; Wei Yuming, Vice Minister, State Import-Export Commission; Lu Xuzhang, Vice Minister, Ministry of Foreign Trade; Wang Weicai, Vice President, Bank of China; Ji Chaozhu, Deputy Director, Department of American-Oceanian Affairs, Ministry of Foreign Affairs; Xu Gang, Deputy Director, State Statistical Bureau; Liu Zhicheng, Commissioner, General Taxation Bureau, Ministry of Finance; Li Shude, Director, Third Department, Ministry of Foreign Trade; Pei Chao, Deputy Director, Technology Transfer Department, State Import-Export Commission; Niu Licheng, Deputy Commissioner, General Taxation Bureau, Ministry of Finance; Zhang Hui, Deputy General Manager, Credit Department, Bank of China; Liao Xishun, Division Chief, Office of Economic Reform Under the State Council; Cheng Yiyan, Division Chief, Customs General Administration; Zhao Mingde, Division Chief, Department of International Economic Co-operation, State Import-Export Commission.

Zhu Fugen, Division Chief, Technology Transfer Department, State Import-Export Commission; Zhao Hong, Division Chief, People's Construction Bank of China; Ni Yaoli, Deputy Division Chief, Department of American-Oceanian Affairs, Ministry of Foreign Affairs; Liu Yi, Deputy Division Chief, Department of Treaty and Law, Ministry of Foreign Affairs; Zhang Yiming, Deputy Division Chief, General Taxation Bureau, Ministry of Finance; Xing Yushu, Deputy Division Chief, Loan Projects Office, State Import-Export Commission; Liu Chu, Deputy Division Chief, Foreign Investment Department, State Import-Export Commission; Zhang Zhenping, Deputy Division Chief, Department of External Finance, Ministry of Finance; Zuo Benjun, Deputy Division Chief, Department of Budget, Ministry of Finance; Yu Kangnian, Deputy Manager, Credit Department, Bank of China; Zhang Guochen, Deputy Division Chief, Third Department, Ministry of Foreign Trade; Tie Dazhang, Deputy Chief, Foreign Affairs Department, Statistical Bureau; Li Miao, Section Chief, Department of External Finance, Ministry of Finance; Cheng Shibiao, Staff, Third Department, Ministry of Foreign Trade; Wang Licheng, Staff, State Import-Export Commission; Li Shuming, Staff, General Taxation Bureau, Ministry of Finance; Wu Changgen, Staff, Bank of China; Wang Deyu, Staff, State Statistical

Bureau; Cheng Yan, Interpreter; Zhang Zhixiang, Interpreter; Zhao Xianglin, Interpreter; Jing Ligang, Interpreter.

U.S. WORKING GROUP PARTICIPANTS

Finance and Investment.—Marc E. Leland [1] (Treasury); Dr. Sprinkel (Treasury); William Draper III (Exim); Raymond Albright (Exim); Sidney A. Williams (OPIC); Robert A. Cornell (Treasury); Patricia A. Haas (Treasury); Philip T. Lincoln (State); Christopher R. Holmes (TDP); Mark Z. Orr (USTR); Norman A. Bailey (NSC).

Trade—Eugene Lawson [1] (Commerce); Richard W. Mueller (State); Mark Z. Orr (USTR); Dave N. Laux (Commerce).

Information Exchange.—Anthony C. Albrecht [1] (State); Bruce B. Palmer (Treasury); Robert N. Field (CIA); Richard Boucher (State).

Tax.—John E. Chapoton [1] (Treasury); Alan W. Granwell (Treasury); Marcia D. Field (Treasury); Steven R. Lainoff (Treasury).

CHINESE WORKING GROUP PARTICIPANTS

Finance and Investment.—Pei Chao [2] (State Import-Export Commission); Zhang Hui (Bank of China); Zhao Mingde (State Import-Export Commission); Zhu Fugen (State Import-Export Commission); Zhao Hong (People's Construction Bank of China); Xing Yushu (State Import-Export Commission); Liu Chu (State Import-Export Commission); Zhang Zhenping (Ministry of Finance); Zuo Benjun (Ministry of Finance); Yu Kangnian (Bank of China); Wang Licheng (State Import-Export Commission); Wu Changgen (Bank of China); Zhang Zhixiang (Interpreter).

Trade.—Li Shude [2] (Ministry of Foreign Trade); Zhang Guochen (Ministry of Foreign Trade); Cheng Shibiao (Ministry of Foreign Trade); Jing Ligang (Interpreter).

Information Exchange.—Xu Gang [2] (State Statistical Bureau); Liao Xishun (Office of Economic Reform under the State Council); Tie Dazhang (State Statistical Bureau); Wang Deyu (State Statistical Bureau); Zhao Xianglin (Interpreter).

Tax.—Liu Zhicheng [2] (Ministry of Finance); Cheng Yiyan (Customs General Administration); Liu Yi (Ministry of Foreign Affairs); Zhang Yiming (Ministry of Finance); Li Shuming (Ministry of Finance); Cheng Yan (Interpreter).

APPENDIX IV

PRESS RELEASE, NOVEMBER 18, 1981

The United States-China Joint Economic Committee met for its second annual session in Beijing, China, on November 16, 17 and 18, 1981. The United States Secretary of the Treasury Donald T. Regan and the Chinese Vice Premier Bo Yibo cochaired the meeting. Representatives of numerous ministries and agencies of both governments participated. Mr. Arthur W. Hummel, Jr., the United States Ambassador to China, also attended the meeting.

The Joint Economic Committee was established in 1979 shortly after the establishment of diplomatic relations between the two countries. It is designed to serve as a focal point for coordinating the entire spectrum of U.S.—China economic relations.

Since the establishment of diplomatic relations between the two countries, U.S.-China economic relations have grown at a rapid pace. Two-way trade was $1.2 billion in 1978, doubled in 1979 and again in 1980, and is expected to be approximately $5.5 billion this year. Bilateral banking relations have also expanded. Seventy-three U.S. banks now have correspondent relations with the Bank of China which this week opened a branch office in New York City. Business and investment ties have also grown.

A series of formal bilateral agreements signed over the past two years between the two governments, pertaining to claims settlement, trade, textiles, grain, civil aviation, maritime relations, export credits and government insurance and guarantees of private investment, have provided a sound basis for the expansion of U.S.-China economic relations.

In addition to two plenary sessions which reviewed the overall economic relationship, four working groups conducted indepth discussions of specific issues. The four working groups concentrated on taxation; finance and investment; exchange of economic information; and trade.

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[1] U.S. Chairmen.

[2] Chinese Chairmen.

In the tax area, representatives of the two governments initiated negotiations on a comprehensive tax treaty as well as on a limited bilateral income tax treaty relating to reciprocal exemption from taxation of earnings of aircraft and ships. They exchanged letters with respect to the reciprocal exemption from taxation of shipping revenues. In addition, representatives of the two governments exchanged letters relating to an understanding with respect to the taxation of aviation profits.

The representatives of the two governments noted that the scope of the exemption from earnings would be expanded in the overall bilateral tax treaty without regard to where the vessel or aircraft is registered. Both sides also discussed China's tax laws and their applicability to foreign firms investing in China.

In the finance and investment area, representatives of the two governments discussed investment opportunities in China, China's access to U.S. government finance programs and private capital markets in the U.S. China noted that the energy, transportation, agriculture, and light industry sectors offer possibilities for financial and technical cooperation.

The U.S. noted that the primary source of U.S. financing available to China is the United States private sector. In this regard, the U.S. agreed to facilitate contacts between China and private U.S. banks and other financial institutions.

U.S. Government programs with limited resources are also available to China such as the Overseas Private Investment Corporation, the Commodity Credit Corporation and the Trade and Development Program. U.S. officials reaffirmed that the U.S. Export-Import Bank was prepared to continue to make available export credit arrangements for China on a case by case basis to assist U.S. exporters to participate in the implementation of China's modernization program.

Representatives of the two governments reviewed progress to date in exchanging economic information and considered that a good beginning had been made. Both sides agreed to take additional steps to facilitate the flow of economic information and experts. It was noted that each side may contact any relevant agency of either government for information. In addition to the normal, on-going exchanges with relevant agencies, steps were taken to facilitate replies to requests for information. The two sides reached an understanding that efforts would be made to obtain appropriate responses to inquiries and to arrange appropriate programs for visiting experts. Both sides agreed that a better understanding of each other's economies would help strengthen economic ties.

In the trade area, China and the United States reviewed the growth in bilateral trade over the last two years and discussed some of the problems involved in the bilateral trade as well as ways and methods to solve them.

Representatives of the two governments discussed the soon-to-be-formed Joint Commission on Commerce and Trade and had preliminary conversations on topics for discussion at its first meeting next spring, and issues to be resolved at that meeting. Both sides hope that this Commission will play an active role in promoting bilateral trade, exploring ways to minimize trade obstacles, and giving an impetus to trade.

With regard to the reciprocal establishment of Government Trade Offices, it was agreed that the American Embassy in Beijing will continue discussions with the Ministry of Foreign Trade and that they would make every effort to conclude an agreement in the near future.

While in Beijing, Secretary Regan also met with Vice Chairman Deng Xiaoping and Premier Zhao Ziyang.

This meeting is the second in what will be a series of annual meetings of the Committee. Both governments emphasized that the annual meeting is part of an ongoing process of strengthening and expanding the economic relationship between China and the United States.

It was agreed that the next annual meeting of the Joint Economic Committe will be held in Washington in the fall of 1982.

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